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VENTURING TO AFRICA
Overcoming Obstacles for Finnish VC Firms to Invest in Africa

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Tiivistelmä - Referat - Abstract

The African start-up scene has been rapidly developing in recent years and respected Silicon Valley VC firms and large tech companies are moving in on the market which could be regarded as a signal of opportunity. Yet a single investment is to be made by a Finnish VC firm into an African start-up.

The democratizing effect of technology and internet accessibility has led to the growth of innovation and disruption on the continent with the three selected jurisdictions for the thesis South Africa, Nigeria and Kenya leading the charge. Focusing on the three countries enables more a pragmatic analysis and thus applicable solutions. Analysing three different ecosystems also showcases the heterogeneity of the continent's opportunities for VC firms.

The objective of the thesis is to establish the main blockers for Finnish VC firms when weighing the option of investing in Africa and then provide solutions to overcome the obstacles whilst taking a form of a roadmap to also show the process of investing in Africa and its peculiarities.

Because of the specificity and novelty of the subject matter, there is very little research specific to the objective to build on. To paint a picture of the different ecosystems' comparative legal analysis and market analysis was utilized. The obstacles were identified through thematically analysed qualitative interviews with Finnish VC firms. The solutions to these obstacles were built on qualitative interviews with individuals that have experience from the African start-up scene.

Four obstacles rose above the rest in prevalence: mandates, being geographically far from founders, local expertise & networks and corporate governance & unknown risks. Based on the four obstacles a prescription of four actions that enable a Finnish VC firm to invest in Africa was developed: *1. Cannot be focused on early stage start-ups. 2. Needs to find a local co-investor. 3. Cannot have a mandate blocking Africa as an investment option. 4. Is a specialized fund.* By adhering to these four "rules" a Finnish VC firm can venture to Africa with confidence.

Avainsanat - Nyckelord
Pääomasijoitus, Afrikka, Nigeria, Etelä-Afrikka, Kenia, Startup, kehittyvät markkinat

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Abbreviations

AGDI	African Governance and Development Institute
AI	Artificial Intelligence
ARD	American Research and Development Corporation
AUM	Assets Under Management
AVCA	African Private Equity and Venture Capital Association
BPO	Business Process Outsourcing
B2B	Business-to-Business
CAGR	Compound Annual Growth Rate
CAMA	Companies and Allied Matters Act
CFI	Corporate Finance Institute
CMA	Capital Markets Authority
CVC	Corporate Venture Capital
DFC	U.S. International Development Finance Corporation
DTT	Double Taxation Treaty
DVCA	Danish Venture Capital and Private Equity Association
ECGI	The European Corporate Governance Institute
EIB	European Investment Bank
EIF	European Investment Fund
EMPEA	Emerging Markets Private Equity Association
EPZ	Export Processing Zones
ERISA	Employee Retirement Income Security Act
EU	European Union
FDI	Foreign Direct Investment
FIBAN	Finnish Business Angel Network
FIN	Finland
FVCA	Finnish Venture Capital Association
GDP	Gross Domestic Product
GII	Global Innovation Index
GP	General Partner
GSMA	Global System for Mobile Communications Association
H1	The first half of the year
ICT	Information and communication technology
IFC	International Finance Corporation
IP	Intellectual Property
IPO	Initial Public Offering
IRR	Internal Rate of Return
LP	Limited Partner
MEE	Ministry of Employment and the Economy (FIN)
NBER	National Bureau of Economic Research (US)
NCCG	Nigerian Code of Corporate Governance
NVCA	Nordic Venture Capital Association
OBOR	One Belt One Road
OPIC	Overseas Private Investment Corporation
PE	Private Equity
PwC	PricewaterhouseCoopers
ROI	Return on investment
SAAS	Software as a solution

SAVCA	Southern African Venture Capital and Private Equity Association
SICAR	Société d'investissement en Capital à Risque
SVCA	Swedish Private Equity & Venture Capital Association
SD	Standard Deviation
TRIPS	Agreement on Trade-Related Aspects of Intellectual Property
TVPI	Total Value to Paid-In Capital
UK	United Kingdom
US	United States
VC	Venture Capital/Venture Capitalist
WIPO	World Intellectual Property Organization
WP	Washington Post
WSJ	Wall Street Journal
YoY	Year-over-Year

1 Introduction

1.1 Background and Objectives

”...the entrepreneur is the modern-day cowboy, roaming new industrial frontiers much the same way that earlier Americans explored the West. At his side stands the venture capitalist, a trail-wise sidekick ready to help the hero through all the tight spots – in exchange, of course, for a piece of the action”.[1] To extend the metaphor: Africa is a relatively unexplored investment frontier with benefits to reap for those willing to take it on.

To take on the continent requires handling risk and uncertainty unique to Africa. Historically the legacy left by colonialism, political uncertainty, corruption, inequality, adverse weather, disease, population displacement and conflicts have weighed down the economic development of the continent.[2] That is the side of Africa that has gained most of the attention and created preconceptions impeding the interest in the region.[3] There are also many positive trends that might come as a surprise to the general reader. Half of the twenty fastest growing GDPs in the world in 2019 are African.[4] The democratization of technology enabling disruption and innovation by an ever-widening class of people is changing the landscape of opportunities. The continent has the fastest growth globally in internet and smartphone adoption[5] and Sub-Saharan Africa[6] accounts for 66% of global mobile money transaction volume[7].[8]

Higher risks equal higher returns, this applies for VC too. This places African VC in a unique position if the risk premium of the market is not aligned with reality. It would offer higher

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[1] Zider 1998
[2] Ake 1996
[3] Hagos 2000
[4] World Bank 2019 ”GDP Growth (annual %)”
[5] Bright 2020 (TechCrunch)
[6] Countries south of the Sahara desert on the continent. There are 54 countries that fit this description.
[7] The value of mobile payment transactions in Sub-Saharan Africa: €415bn, Active mobile payment accounts in Sub-Saharan Africa: 159mil, Mobile payment transaction volume in Sub-Saharan Africa: 27,4bn. This means that Africa seems to be skipping cards and moving from cash straight to phones in the payment evolution.
[8] GSMA 2021

returns for those willing to venture into Africa and be able to mitigate risks through experience and knowledge.[9] Many VC firms have recognized this potential; foreign VC accounts for over 80% of the deals made.[10] China and the US lead the pack at almost half of the capital invested in start-ups on the continent.[11] With Chinese VC investment expected to grow aggressively in the coming years.[12] Additionally, Japanese VC firms have started moving in on the continent as their domestic market has become oversaturated with capital.[13] This recent interest in African VC has made it one of the fastest-growing start-up and VC spaces globally. The amount of investment in the region grew tenfold from 2015 to 2019 but is still far from its full potential at six times smaller than India and a fourth of Latin America.[14]

If the African market is attracting a lot of foreign capital and seems to be the next VC gold rush, why is none of the capital Finnish? Finland has a strong a start-up culture and knowledgeable VC firms looking to impact and disrupt. Even from a more practical stand-point Finland is in the same time zone, there is no language barrier since most countries have English as a primary or secondary language and because of the strength of the Euro and the relative difference in costs of running a business Finland is in a prime position to invest.

The thesis will examine what is stopping Finnish VC firms from joining the party. More concretely the objective of the thesis is to establish the main blockers for Finnish VC firms when weighing the option of investing in Africa and then provide solutions to overcome them. Additionally, to support the venturing to Africa the thesis will take a form of a roadmap explaining the basics and peculiarities of a market where the current successes only begin to scratch the surface of its potential.[15]

1.2 Methodology and Scope

As the thesis is attempting to open the gate for Finnish VC firms to venture to Africa it has to be approached not just as an academic paper with legal analysis but also as a business case

[9] See Sahlman 2012
[10] Digest Africa 2020
[11] ibid
[12] Adeoye 2020 (VC4A)
[13] Dall 2020 (Ozy)
[14] EMPEA 2020 ”Trends In Global VC+Tech EMPEA’s Inaugural Report On Venture-Backed Startups Across EM” The reason the comparison is made is the similar size
[15] See Carbone 2018

to be useful. The marriage of these three styles is so innate that without pointing out the approach taken it might go unnoticed.

The title of the thesis deceives to some extent; to look at Africa as a whole would not align with the goal of the thesis for a few reasons. Firstly, Africa is not a homogenous continent. Each country has its strengths and challenges from the point of VC investing.[16] Secondly, when looking at Africa as a whole the amount of information to cover would be so vast that by keeping to the maximum thesis length only a scratch of the surface would be possible. This would not give real business applicability. Thirdly, by choosing the countries to focus the thesis on it steers the reader to concrete markets and takes the first step in venturing to Africa for the VC firm; selecting the most potential start-up markets.

The fact that three countries were chosen lead to a lengthy thesis but it was the only way to reach the goals of the thesis. The countries chosen for the thesis deep dive are South Africa, Nigeria and Kenya. The choice of these countries is based on three facts: they have the most activity, they are all different from a VC point of view and they all have English as one of the primary languages. South Africa, Kenya and Nigeria combined account for 53% of the continents VC activity[17] from 2014 to 2019.[18] They are all seen as the main hubs of innovation and disruption on the continent with strong internal markets but all different in market composition and its supportive infrastructure, as the thesis will highlight.[19] Finally, the fact that all the countries have English as one of the primary languages was vital from the point of having a good base of local sources that were easy to extract knowledge from.[20]

To analyse these countries a multitude of methods are applied. The thesis covers four legal systems with their respective peculiarities.[21] To grasp the challenges that venturing to these new legal plains entail a comparative analysis of the different environments is performed.[22] The base is the Finnish legal framework for VC investing which belongs to the civil legal family. All the African target countries have mixed legal systems which adds another level

[16] Groh and Wallmeroth 2016
[17] This is an especially high number when taking into account the fact that 21% of the continent's VC activity is headquartered outside of Africa so these three countries represent 67% of VC activity.
[18] AVCA 2020 "Venture Capital in Africa: Mapping Africa's start-up investment landscape"
[19] See De Beer et al. 2016
[20] Negash 2011
[21] See Sarbah et al. 1987
[22] Siems 2018

of complexity to the analysis. The different African legal systems analysed for suitability of VC activity (*lex lata*) were delved into with the view on the nature of law being a social fact. The legal landscapes of the selected African countries have a fair amount of customary law and informal practices that would not be apparent when examining it as a purely procedural phenomenon.[23]

VC funds do not make investment decisions solely based on the legal environment, so the potential target markets are examined from a business point of view too[24] using statistics on the market and research into the qualitative elements affecting the market.[25] Again as a baseline, the Finnish start-up market is examined to create comparable statistics and market characteristics. The reader gets, like with the legal landscape, an idea of what the current operational environment is like and what kind of environment the firms would be heading into.

In addition to the legal and business environment analysis, qualitative interviews are employed to identify the obstacles and give solutions to them. The interviews are thematically analysed.[26] The first round of interviews is conducted with Finnish VC firms to figure out what obstacles they see in investing in African start-ups. The methodology of those interviews is delved into in Chapter 5.1. As for the solutions to the obstacles, they are gathered by interviewing people working in the African start-up space. The methodology applied for the solution creating interviews is covered in more depth in Chapter 6.1. The information gathered from the interviews gave great insight into the market far beyond what was possible even with a thorough probe into the available research output.

1.3 Approach with Sources

The start-up space is so dynamic and rapidly evolving that information becomes quickly obsolete.[27] Examining this dynamic environment in a region that generates below 1% of the

[23] Van Hoecke 2011
[24] The division in the thesis of legal and market analysis in the build-up to the obstacles and solutions is equal. The writer of the thesis did not plan this but it happened naturally as a result of trying to create an all-encompassing view of the African markets.
[25] See Adongo 2012
[26] Alhojailan 2012
[27] See McCann 2018

world's research and the local start-up space is still in a nascent stage[28] was something that the writer of the thesis knew would be a major challenge from a source standpoint.[29]

The fallout of not having an abundance of literary sources was the inordinate use of website sources for a thesis. Website sources were used once it was determined that no applicable literary work could fill the gap of needed knowledge. To minimize the chances of false information the websites used were vetted by mirroring other information confirmed through other sources against the output of the website. When possible, websites of organizations or household news agencies were prioritised. As an example of why in some cases website sources had to be prioritised; a lot of the literature on Nigeria was from the 80s when the initial oil boom started and though it covered investing as a foreign entity in the country the applicability of those finding to the current state of the country is debatable.[30]

The relatively nascent stage of the start-up space in all three countries manifested itself in the lack of cases available for dissection. Scouring the case libraries of each respective country VC firms have been involved in very few cases, often relating to areas outside the scope of this thesis like wrongful dismissal. Besides the nascent stage of the start-up space, two other reasons contribute to this. Start-ups are modest in capital reserves so even victorious litigation might not bring any returns and often the structures of start-ups that are invested in by VC firms are complicated cross-border matters so suit might be brought in a number of jurisdictions outside the three selected countries, so the legal analysis was mostly based on the codified legislation of the countries and literature around its effectiveness.

In addition to recency, consistency of information was given great consideration. This was especially important with financials since different sources had disparities in market size of tens of percentages[31]. The numbers quoted are carefully selected to be realistic and consistent across the thesis. Sources used for numerical data or target market info were always as recent as possible but with sources relating to the standards of the VC e.g. attitudes towards risk, the reputability took precedence within reason.

[28] Onukwue 2020 (TechCabal)
[29] Duermeijer et al. 2018
[30] See Pinto 1987
[31] In absolute values, the differences were sometimes in the hundreds of millions.

The interviews[32] with Finnish VC firms and current investors in Africa were a way to really get up-to-date and concrete information on a subject that has very limited research up to this point and was the biggest value add to the prevailing of the thesis. The interviews also shaped other areas of the thesis than the obstacles and solutions as the free discussions in some cases stretched out and pointed to new avenues of information in the VC space.

1.4 Outline

The thesis is divided into three main parts. Chapters 2 and 3 are introductory to the subject matter and create a knowledge base of VC in Finland and Africa. Chapter 4 dives into the three selected countries analysing the jurisdictions suitability for start-ups and VC investment. Chapters 5 and 6 building on interviews and research examine the obstacles and solutions for Finnish VC firms to invest in Africa. In pages, the division is right down the middle with an even balance between theory and the analysis.

Chapter 2 explains the history, current state and framework for VC investments globally and in Finland. The legal framework and investment process in Finland is covered in great detail to enable comparisons with the investment process and laws governing it in the chosen target countries so the differences that Finnish VC firms would need to adapt to are clear. Chapter 3 takes a more statistical approach and examines the VC space of the entire continent focusing on the trend of foreign VC firms entering the market building up the base argument of the thesis that there are reasons to venture to Africa. Chapter 3.3 lays out the investment process for Finnish VC firms in Africa highlighting the additional steps it might entail.

Chapter 4 analyses the start-up environments of the chosen African countries comparatively. It takes an in-depth look at the legal environment to concretize certain legal aspects of venturing into the market[33] e.g. taxation and paints a picture of the country and its start-up ecosystem. Chapter 5 covers the four most prevalent obstacles expressed by the Finnish VC firms and the methodology used to gather and process the data. Chapter 6 analyses the obstacles one by one and attempts to list potential solutions for them. Chapter 7 ties it all together and highlights what lessons a VC firm considering venturing to Africa can take away from the thesis.

[32] For a full list of people interviewed see Appendix C.
[33] Areas that were left open in Chapter 3.3. that require a country-by-country analysis.

2 Venture Capital

2.1 Introduction

Venture capital is the funding of promising companies in the early stages of their lifecycle in hopes of a high return. The following oversimplified math explains the basis for the outlook: 97% of VC profits come from 0.1% of the companies invested in. This means that 0.1% of the companies have to cover the losses incurred from the 99.9% and make a risk-reflecting return[34] on top of that.[35] Facebook is an extreme example in demonstrating how one investment can cover losses and then some. In 2005 Accel[36] invested $12.7mil in Facebook when the company was valued at $100mil. Seven years later they were able to cash out at $9bn[37] representing a 70,766% ROI.[38] Facebook is currently one of the eight largest companies globally by market cap in May of 2020. Seven[39] out of the eight have been backed by VC at some point in their journey.[40]

The financial realities of the VC industry mentioned above create certain parameters that a target company of a VC firm needs to fulfil. The start-up should be innovative, even to the level of disruption creating new industries like AirBnB, and with potential for rapid international growth through a scalable business model.[41] The stages a start-up goes through during its journey of growth differ based on the source but a common thread is a division into five stages. The division most commonly used is: seed, angel investment, early stage, later stage and finally the exit.[42] Seed investments are often funded by the so-called three Fs: friends, family and fools. A seed stage company is often pre-revenue and might be operating out of someone's bedroom as a side project.[43] At the angel investment stage business angels[44] invest in the company which is still early on its path but has most likely already moved out of

[34] VC firms take on a lot of risk so funds are expected to triple in value within their 5 to year 10 cycle
[35] Lecture at Amazon offices in Stockholm on the 22nd of June 2020 by Jyri Engerstöm from Yes.VC
[36] Palo Alto, California based VC firm
[37] As of writing (15.1.2021) the same investment would be worth about $89bn (excluding post IPO dilution)
[38] Tam and Raice 2012 (WSJ)
[39] Alphabet, Apple, Amazon, Facebook, Microsoft, Tencent, Alibaba
[40] Lerner and Nanada 2020
[41] FVCA "Find the right investor"
[42] Löning 2017
[43] Pajarinen et al. 2016
[44] Private individuals making investments of over €10k into growth companies they have no familial ties with. Ideally the company grows and gets eventually bought out.

the bedroom.[45] At this stage, VC investments can be attracted for the first time when the start-up has established its output to a level that the VC firm is not just investing in an idea.

In the early stage, a company most likely already has a turnover and might even be profitable with hopes that additional capital and advice can take it international or just scale it to the next level. The early and later stage hold within themselves funding rounds which are divided into series: Series A and B are classified as early stage and series C and onwards[46] are later stage. Early stage investments globally average between $1 and $30mil and later stage are upwards of $10mil.[47] When a VC firm invests in a company in the early stage it often takes a non-controlling equity stake to share the business risk and profit from the potential exit. The minimum timeframe of an average VC investment is 3 to 7 years.[48] After this period of nurturing, and if the start-up is still alive, the VC can start looking for an exit option through an equity deal or an IPO[49].[50]

Besides finances, the VC firm invests its knowledge and connections. This is referred to as active ownership, though not always practised. Especially larger VC firms where most of the effort goes into entries and exits are not that hands-on.[51] The base idea with active ownership is that start-ups are challenging the status quo so their founders are often highly skilled in the science or technical area of the start-up but might be lacking in critical business skills, that is where the experience of the VC firm comes in. A VC firm can for example assist with strategic planning, recruitment and creating a more solid governance structure.[52] Start-ups that are actively owned by VC firms perform on average better than their independent counterparts.[53]

The expected exit potential, time frame to maturity and the need for swift scalability create barriers for numerous industries and business models to gain VC investment. From the

[45] See Etula 2017
[46] In its “investment type” -category Crunchbase has Series A to J
[47] Crunchbase 2021
[48] FVCA “What are venture capital and private equity?”
[49] For start-ups with ambitions of going public receiving VC is a good sign. Half of the entrepreneurial companies that go public in the US have had VC backing.
[50] Lerner and Nanada 2020
[51] Interview with Markus Dietrich, Analyst, Hadean Ventures (Stockholm, Sweden, 10th of July 2020)
[52] FVCA “What are venture capital and private equity?”
[53] Botazzi et al. 2008

600,000 new businesses that start their journey only a few thousand raise venture capital and just 7% of start-ups that file a patent have VC backing.[54]

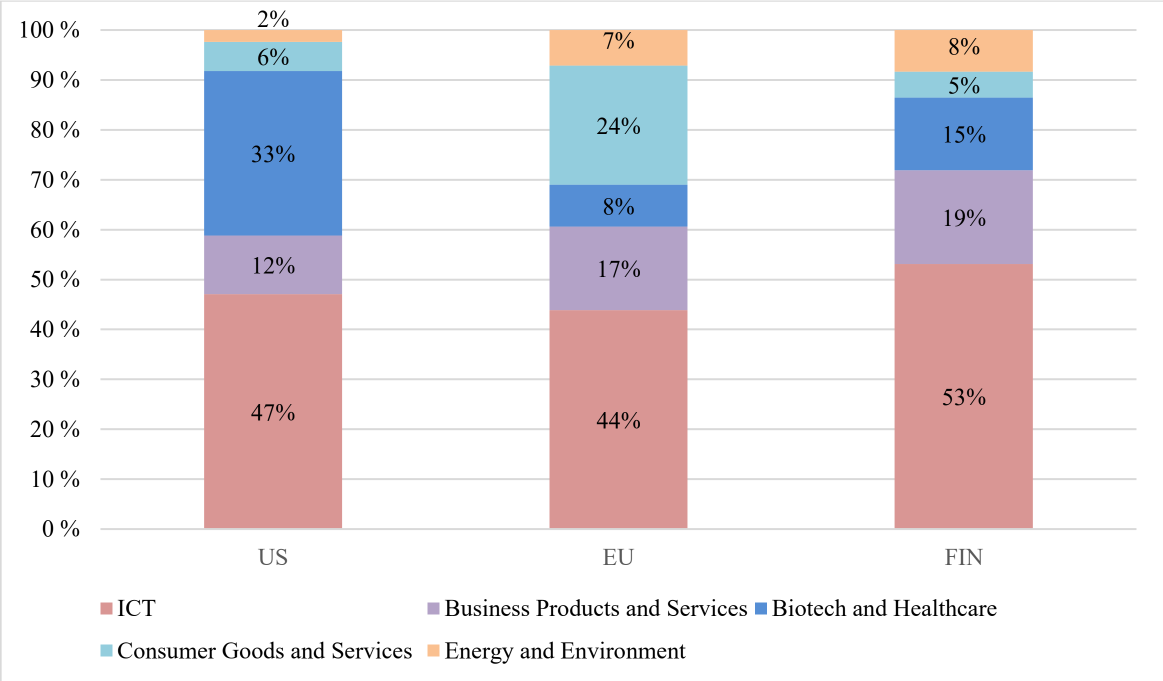

Figure 1. Venture capital investment by industry and region.[55]

As the table demonstrates, the ICT industry is overwhelmingly the largest across all the regions. The definition[56] itself is quite all-encompassing but essentially the ICT industry fits the mould of an ideal investment target. ICT companies often have scalable products and business infrastructures are moderately easy to expand. As an example, SAAS companies like Dropbox[57] or Mailchimp[58] are quickly and cost-efficiently scalable and their products need for their product is similar across the globe.

With the way technology has permeated into all aspects of our life the claim of being a technology company is relatively easy to make which is also an additional reason for the

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[54] Kaplan and Lerner 2010

[55] Statista 2020 “Total value of venture capital investments in Europe in 2019, by sector”, FVCA 2019 “Finnish Venture Capital Activity”, Pitchbook 2019 Although data may not perfectly comparable since definitions of industries by different sources might differ slightly.

[56] “The ICT sector combines manufacturing and services industries whose products primarily fulfil or enable the function of information processing and communication by electronic means, including transmission and display” OECD

[57] File hosting service that can just purchase more cloud storage space as the number of customers grows and online file storage is a product with basically no geographic blockers. (Dropbox.com)

[58] Marketing automation platform on which additional customers add no cost and like with Dropbox only additional cloud infrastructure needs to be purchased and the product is internationally useful. (Mailchimp.com)

ICT sector attracting almost half of VC investments.[59] Tech or ICT is starting to be too big of an umbrella term to actually give a descriptive label[60] to a company and thus subcategories like fintech and healthtech are replacing it as they grow into their own large industries. VC firms might even specialize in a specific type of tech like fintech to gain an edge through more specialized market knowledge and the built network within that industry. On average these specialized firms do better than the industry-agnostic generalist funds.[61]

2.2 History

Setups somewhat similar to those of modern VC covered in the previous introductory chapter have been traced as far back as the twelfth century to Genova, Italy. The stay-at-home investor put forth most of the capital funding with the travelling merchant staying on the road practising his trade and paying back the entrusted capital.[62]

The actual genesis of the concept we now know as venture capital came much later and is attributed to Georges Doriot. In a post-war America in 1946 Georges Doriot became the president of the American Research and Development Corporation. ARD was a public venture capital firm that over the 25-year tenure of Georges Doriot developed over 100 start-ups utilizing the VC toolbox of financing and guidance[63]. Many of these start-ups became successes and became trailblazers in technology and business. The ARD also acted as an equalizer. Thanks to it individuals outside the wealthy family funds[64] were able to get involved in private equity and venture capital.[65]

After its inception, the VC industry remained relatively modest in its impact until the 1980s. A new wave of capital hit the VC world in 1979 when the definition of a “prudent man’s”

[59] Baca 2019 (WP)
[60] The fact that VC firms and investors in general target ICT companies and give them higher valuation multiples because of their potential to grow and scale quickly and painlessly create an incentive to call yourself a tech company, even though you would not be one based on traditional definitions. A great example is the failed IPO of WeWork. WeWork’s main product is co-working spaces so the company should be categorized as a real estate company but WeWork used the word “technology” 93 times in its prospectus and used a high price/sales -ratio more typical of technology companies of 26x in its valuation. A similar-sized co-working company also targeting an IPO used a multiple of 3.5x around the same time raising flags.
[61] Gompers et al. 2009
[62] Krueger 1993
[63] Interestingly one of the companies was an oil rig manufacturing company run by George H.W. Bush
[64] Like the funds of the Rockefeller Brothers.
[65] Ante 2008

care in investment in the Employment Retirement Income Security Act of 1974 was re-interpreted[66] by the Department of Labour to allow riskier investments by pension funds. At first, the pension funds just dipped their toes in by allocating small portions of their portfolios into start-ups but as the 1990s came and start-ups were leading the charge in new disruptive tech the investments grew and money flowed in, and not just into the start-ups, to curb risk pension funds invested in VC firms[67].[68]

The next major uptick in activity came in the mid-1990s. Plenty of new companies emerged spurred on by the so-called dot com boom. As a venture capitalist[69] described the times: ”If you had a pulse and a neat haircut you were probably going to get funded”.[70] The numbers back this up: in the year 1995 a bit under $10bn was invested in VC in the US, by the year 2000 this number was a bit over $70bn representing a 55% annual growth rate in investments. In 2002 after the dotcom crash it was back to the original $10bn.[71] The dotcom crash wiped out a lot of start-ups and VC firms, acting as a sort of reset for the system heading into the new millennia.[72]

The post dotcom crash era experienced moderate growth in VC investments until the financial crisis of 2008 hit. The lack of liquidity and general risk averseness in the market became detrimental to the VC world. Most of VC funding at this point came from banks, pension funds and insurance companies all of which were deeply affected by the crisis. This caused three different actions from investors: 1. The financing institutions lowered their risk exposure by cutting down on their investment levels in VC firms 2. They sold their stakes in VC firms and start-ups to alternative parties that might not be as reliable 3. They completely divested from VC. These actions led to the VC space shrinking, like post the dotcom crash, funding rounds into start-ups were almost halved in 2009 from 2008.[73]

[66] 29 CFR § 2550.404a-1 - Investment duties in the ERISA
[67] The VC firms understood the market better and owning an equity stake in a VC firm instead of start-ups was an easier way to diversify.
[68] Lerner and Nanada 2020
[69] Ted Anderson, partner of Ventures West Management
[70] Conrath 2002
[71] Kaplan and Lerner 2010
[72] Laffey 2004
[73] Block et al. 2010

In the years following the crisis, a clear trend has emerged of a growing number of large later stage investments into start-ups by a smaller pool of actors. When looking at the numbers of this stage, it seems like consolidation within the industry but actually, the type of firm investing VC is changing. The rise of corporate venture capital, mutual funds and sovereign wealth funds in the VC space has shifted the norm of the market. For example, the Silicon Valley early stage investments are dominated by CVC firms like Google, Amazon or Facebook. This has led to the rise in the amount of angel and seed investors.[74]

As chapter 2.1 pointed out, VC firms are not just moving into earlier stages but are also specializing because like in any maturing market competition grows and by focusing on a specific industry a more solid knowledge base can be utilized for attracting start-ups. The value-add of the firm is more attractive to a start-up when they can receive industry expertise on top of financial backing.[75] New VC investors have also been more geographically diverse: in 2006-2007 80% of global VC investments happened in the US, by 2019 the portion is down to 50%.[76]

The most recent impact to VC, as of writing the thesis, is the Covid-19 pandemic. As with the dotcom bubble burst and the financial crisis the expectations were very bleak for the VC space during the pandemic. The data emerging seems to contradict this. The main fallouts are that VC firms have somewhat slowed their investment pace and concentrated more on guiding their target companies through the pandemic. To quantify the effect: the VC industry-wide IRR is down 1.6% which is far below what was at first expected.[77] Like in the economy at large, the pandemic has not affected the VC space equally. For example, healthtech has experienced a huge boom with the healthcare industry looking to digitalize its operations. By Q3 in 2020 healthtech had taken in about 20% more investment than in the year 2019 in total.[78] The losing industries, like travel & tourism or beauty & fashion have been affected heavily losing 70% and 59% of their revenue respectively in comparison with last year.[79] Many VC professionals pointed out that it is too early to see the real full impact of

[74] To possibly avoid competition with the powerful CVC firms for later stage companies.
[75] Harrison R 2019
[76] Lerner and Nanada 2020
[77] Gompers et al. 2020
[78] Pitchbook 2020
[79] McCarthy 2020 (Statista)

the pandemic but based on the initial data it will permanently cause shifts in funding preferences and accelerate certain industries.[80]

2.3 Finnish Venture Capital

2.3.1 History

Like in the US, the genesis of VC-type activity can be tied to a public sector effort. In 1967 the Bank of Finland, in collaboration with private financial institutions, founded Sponsori.[81] The goal of Sponsori, as the name implies[82], was to help small Finnish businesses and ideas flourish and create exportable goods and services rather than turning a profit.[83] The actual emergence of VC in its true form is attributed to Sitra in the 1980s, a foundation at the time also supervised by the Bank of Finland. Sitra has during its years of operation notably financed the internationalization of Kone and funded the research behind the development of Xylitol.[84] In the 1980s the activity of Sponsori also went through a transformation. To be able to take on more risky investments and isolate them Sponsori founded Spontel. Spontel was later criticized for contributing to the casino economy[85] in Finland with its aggressive investing strategy taking on unreasonable amounts of risk and looking for quick returns.[86]

In the early 1990s, Finland was in an economic depression with an almost 20% unemployment rate.[87] During this period Sitra became the largest capital investor in Finland with the private sector for VC still in its infancy. Sitra was moved from the under the Bank of Finland to the Parliament of Finland and given an endowment of Nokia shares[88].[89] During this period, the capital raised by PE firms[90] annually doubled in size YoY to reach €70mil in 1995.[91]

[80] See Gompers et al. 2020
[81] Pajarinen et al. 2016
[82] Sponsori translates to ”Sponsor” in English
[83] Vihola 2000
[84] Sitra “History”
[85] A time when the economy overheated and caused the depression of the 1990s in Finland. Started in the mid-1980s.
[86] Vihola 2000
[87] Kiander and Vartia 1998
[88] Nokia’s exponential growth of share value in the 1990s made the endowment much larger than intended.
[89] Kuusterä and Tarkka 2012
[90] Data on VC separately was not available till 2007. Might be because of the small market no distinction was needed.
[91] FVCA 2016 ”Venture Capital and Private Equity Industry in Finland 2015”

The dotcom bubble is too visible in the growth of Finnish venture investments from the mid-1990s to 2001. The venture investments totalled €176mil in 2001, a number which is yet to be reached as of writing[92], even pre the financial crisis of 2008. In years leading up to the financial crisis, the VC market also experienced a rally in the capital invested. The fall in investments after the dotcom bubble burst was almost 50% whereas post the financial crisis drop-off was just about 16%.[93]

The resilience of VC in the US and Finland post the financial crisis of 2008 or the Covid-19 pandemic might be a sign of its grown importance to the rejuvenation of the economy after a shock and the disruptive and adaptable nature of the lean start-ups that make it up. The change of millennia also marked a rise in soft values into investment space through VC firms increasingly valuing social impact on top of a return.[94]

2.3.2 The Current State

Since the financial crisis of 2008, a lot has happened in Finnish VC. The VC and start-up markets have experienced steady growth, gone through remarkable structural changes and even three new unicorns Rovio, Supercell and CRF Health[95] have brought recognition to the ecosystem.

Finland is ranked 7th in the Global Innovation Index 2020[96]. The ranking is a good indicator of how fertile ground Finland is for start-ups and thus for VC firms. Based on the GII ranking's subcategories Finland's biggest strength lies in its institutions[97] and its most innovation hampering area is market sophistication[98].[99] The market will grow more sophisticated with time if the innovation input and output will stay at their current levels[100] and the market will keep attracting more talent and capital. In comparison, the challenge of having weak IP protection in the ecosystem, for example, is a much harder obstacle to overcome since it requires

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[92] Although in 2020 H1 was record high so it is likely the 2001 funding record will be broken in 2020.
[93] FVCA 2016 "Venture Capital and Private Equity Industry in Finland 2015"
[94] Sitra "History"
[95] Supercell being the only one with any Finnish VC behind it. Accel (mentioned in Chapter 2.1 as the successful investor in Facebook) backed both Rovio and Supercell.
[96] Finland has not dropped below 8th place since 2013. In 2014 Finland was even impressively 4th.
[97] Political environment, Regulatory environment, Business environment, Government effectiveness, Rule of law and Ease of resolving insolvency.
[98] Ease of getting credit, Ease of protecting minority investors and Intensity of local competition.
[99] WIPO 2020
[100] 8th place for both output and input

a colossal governmental effort and does not naturally subside like a lack of market sophistication.

Since 2007 €1,45bn has been invested by Finnish VC firms with the average investment being €740k. In 2019 VC firms invested €158mil representing 14% YoY growth which is a bit over the average 12% YoY growth the investments in the Finnish VC sector have experienced since the financial crisis. To cover these investments €1,86bn of capital has been raised since 2007 by Finnish VC firms. The amount of raised capital has grown on average 31% YoY[101].[102]

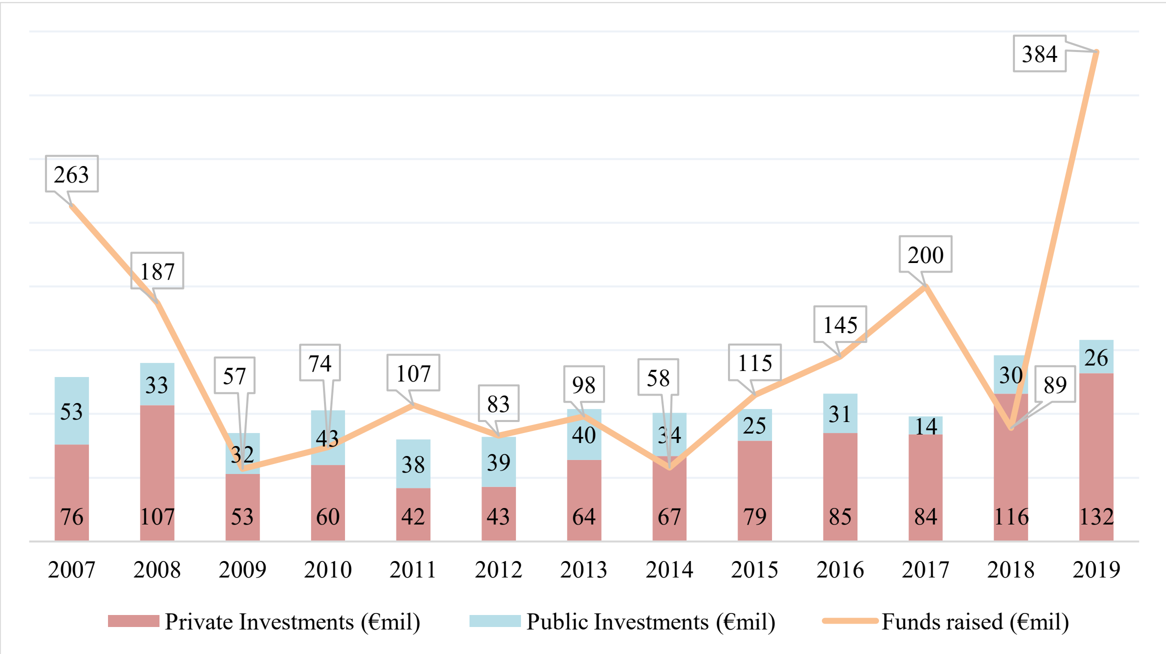

Figure 2. Investments made and funds raised by public and private Finnish VC funds[103]

As it was earlier pointed out: the focus of Finnish VC firms is on the early stage of companies. Out of the €158mil invested in 2019, 18% went to the seed stage, 47% went to the early stage and 34% went to the later stage. The ratio has not always been quite so focused on the early stage. Up to the financial crisis, the focus of Finnish VC firms has been on later stage

[101] This demonstrates the irregular nature of raising capital. Years of growth and years of decline are alternating in capital raising but total investments made have a more of a steady rise. The standard deviations of €91mil in capital raised in comparison with €24mil in investments made confirm this. This is most likely the result of new funds being created. Raising a relatively large amount of capital for the fund's inception in the still fairly small Finnish VC market will skew the statistics and make the funding graph look like a roller-coaster.
[102] FVCA 2020 "H1/2020 Finnish Private Equity Activity: Venture Capital"
[103] ibid

companies with up to 56% of invested capital[104]. As it was earlier mentioned, VC in the US has gone through an opposite shift. Big investments are flowing into the later stages because of CVCs and other new liquid players[105] in the VC market. To compare the numbers 60% of VC goes to later stage in the US.[106] This structural difference might disappear as Finland's market matures and the needed larger players emerge. Currently, the lack of these more liquid players in the Finnish VC market with the ability to finance more ambitious projects is something that is seen as a weakness, not just by local VC associations across the Nordics, but by the earlier mentioned GII.[107]

Another structural change that is a sign of the market maturing that has already happened in Finland is the growth of the ratio of private-to-public VC in the market. The FVCA has 69 members with 35 of them classified as VC firms.[108] On top of this, there are a handful[109] of public actors like the previously mentioned Sitra. The public share of capital invested in start-ups has shrunk from substantial to minuscule. In 2007 41% of VC investments made and 61% of the number of deals in Finland came from a public body. In comparison, in 2019 21% of invested capital and 6% of the number of deals were made by a public fund. This represents the almost doubling of private investments[110] and halving of public investments[111] over the 12-year period.

These structural changes are welcome in the VC market since they are a sign of the strengthening of private VC firms as the goal of public VC is to fill funding gaps. A decline in activity means that there are fewer gaps to fill thanks to a robust private VC market. In a simplistic view, one could argue that capital is capital, and it makes no difference whether it come from a public or private source but as mentioned earlier, firms bring much more to the table than capital.

[104] In 2007 and 2008
[105] Sovereign wealth funds for example. The sheer capital these new actors are bringing to the market might be skewing the data with traditional VC firms still most likely focusing on earlier stages.
[106] Statista 2020 "Value of venture capital investment deals in the United States 2019, by stage"
[107] Nordic Venture Capital and Private Equity Associations 2018
[108] FVCA "Members"
[109] Business Finland Venture Capital, Finnvera, Sitra, Tesi
[110] Private investments in 2007: €76mil and 2019: €132mil.
[111] Public investments in 2007: €53mil and 2019: €26mil.

Active ownership is an important part of taking the start-up to the next level and public VC funds perform worse[112] on average than private funds, even private & public partnerships perform worse than private funds[113]. There could be several reasons why this is the case. First of all, public VC is filling funding gaps, which are there for a reason. The gaps exist because of immense risk[114] or that the target company's mission is one that does not lead down the path of high profitability[115] or profitability at all[116]. Secondly, the public VC funds are not able to nurture the investments in an equally effective manner as the private ones. The strength of public funds lies in their far-reaching networks in the innovation ecosystem[117]. This network helps them identify ground-breaking projects early but not to manage the investments. As the study suggests, this should naturally move public VC into the earlier stages of the start-up lifecycle and private VC would step in when the investments are to be patented and shifted into a higher gear.[118]

To quantify the power of active ownership by private VC firms in Finland two measures: the growth of turnover and increase in personnel are utilized. VC firms expect rapid growth and that is what they seem to get; the 5-year CAGR-% growth of turnover is almost six times as high[119] as of the firms in the peer group[120] at 42,4%[121]. With personnel growth, the 5-year CAGR-% growth of people employed was 2.6 times higher than in the peer group[122] at 11,6%.[123] The growth is not of course not entirely linked to active ownership but is partly explained by the ability of VC firms to pick the firms with the most potential so the statistics are not just a testament of good active ownership but a portion of the success is owed to the capability of picking the "winners". Even with their ability to pick winners, on average 65% of portfolio companies do not survive the lifetime of the fund.[124]

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112 In patents filed, which is the typical measure of innovation in start-ups.
113 The study was done on UK VC which is more mature than the Finnish VC market, so applicability is not ideal.
114 For example, an experimental therapy based on university research with a long time-to-market.
115 Targeting a problem that is faced by a small number of people or a part of the population with low buying power.
116 Firms that target the social or environmental "profit" instead of financial.
117 Universities or science parks for example.
118 Pierrakis and Saridakis 2017
119 6.5 times if Supercell is counted.
120 Companies with over €100k turnover in 2016 in Finland excluding the 0,5% fastest growing and the 0,5% slowest growing companies that do not have VC funding.
121 vs. 7,1% (Peer)
122 vs. 4,4% (Peer)
123 KPMG and FVCA 2019
124 Starting Up -course at Aalto University (starting-up.org)

When the VC industry grows it is able to bring this growth to more and more start-ups and affect the economy at large, this growth extends beyond just the start-ups they are invested in. Every euro of return for investors has a 2 euro spill-over effect on the economy[125].[126] This in combination with the statistics on employment and revenue growth reinforce the idea of VC being a great stimulator for the economy and Finnish VC firms specifically being skilled in what they do. Keeping in mind the goal of the thesis; the potential impact the VC firms could have in the African communities they target, on top of the profit they take home, is promising.

2.3.3 Legal Framework Along the Lifecycle of a Finnish VC firm

The Global Innovation Index of 2020 ranks the Finnish rule of law as number 1 globally with a full 100 points.[127] This means that the laws with which VC firms will interact are enforced to the highest standard; it does not comment on their suitability for innovation.[128]

There is no specific law governing VC activities in Finland, the funds follow general corporate and contract law which are unfortunately not always suitable for the particularities of VC.[129] The actual vehicle for investment, the VC fund, is ordinarily set up as a fixed term[130] limited partnership.[131] The limited partnership in Finland enables for the "liability of one or more, but not all, of the partners for the partnership's obligations to be[132] limited to the amount of asset contribution specified in the partnership agreement".[133] The VC firm acts as the general partner managing the investments and taking on all the liability for the fund in the form of a limited company and the investors[134] supply the capital for investments as the limited partners of the partnership for the fund.

[125] And this figure is on top of job creation and B2B purchases.
[126] Nordic Venture Capital and Private Equity Associations 2018
[127] WIPO 2020 "Finland"
[128] WIPO 2020 "Conceptual Framework"
[129] Johansson et al. 2011
[130] The Partnership Act allows up to a 10-year fixed term partnership after which it can be liquidated at the behest of any partner unless another term of up to 10 years has been agreed during the first 10 years. This is the reason most likely behind the 10 years the typical fund lives (with possible extensions of a few years).
[131] PwC and FVCA 2006
[132] "is" changed to "to be" to make the sentence flow
[133] Section 1(2) of Chapter 1 of the Partnership Act
[134] Pension funds, insurance funds, banks, funds, corporation

The ability to set the fund up for a fixed term[135] and having a lot of flexibility for the raising and distribution of capital make the limited partnership the favoured choice, and not just in Finland.[136] Limited partnerships are also preferred in the US[137] and elsewhere in Europe[138] for VC fund structures.

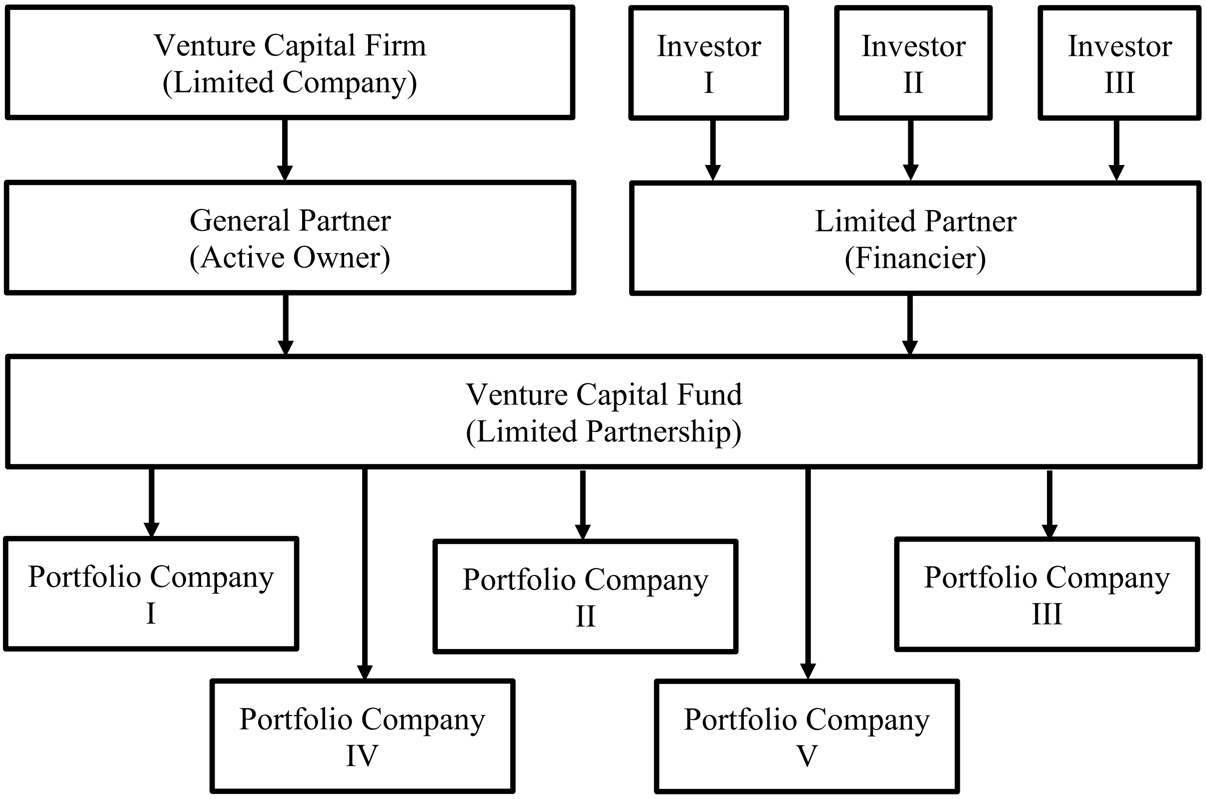

Figure 3. Structure of a VC fund

Capital raised for the VC fund comes from pension funds, insurance funds, banks, funds, private investors and corporations.[139] It is customary in Finland for the General Partner to put down 2 to 5% of the capital.[140] This way the VC has "skin in the game" aligning their incentives with the limited partner. Research has also proven that by risking their own capital from their balance sheet the VC firm performs better as a fund manager. Higher the allotment of the VC firm better the returns, up to a point. The optimal amount of "skin in the game"

[135] The partnership period.
[136] PwC and FVCA 2006
[137] Litvak 2009
[138] Barnes 2007
[139] PwC and FVCA 2006
[140] Business Finland 2017

by the VC firm is a tight balancing act between motivation to perform and risk-averseness.[141] The infliction point for optimal performance by the GP has been found at 11.5% which is much higher than the Finnish market average.[142] As an example, the Finnish VC firm Icebreaker[143] has a 2% capital stake in its fund from 2018[144]. The largest serving of 30% of the fund belongs to Tekes[145] and "Family offices and seasoned tech entrepreneurs" come in second at 28%.[146]

Once sufficient capital for the fund is raised it is time to scope out investments. When a potential target company is discovered[147], the due diligence process starts. Due diligence can take anywhere from a few weeks to a couple of months depending on the complexity of the scrutinized company.[148] Areas commonly covered are the product and the magic behind it, potential customers, the market, competition landscape, the management team's expertise, the business model and financials[149].[150]

As start-ups are not publicly traded and their whole being is based on their propriety, the information the VC firm needs to make an investment decision is not publicly available. To get access to the inner workings of the target firm[151] to get the information on the abovementioned areas an NDA needs to be signed. Based on the NDA template for Finnish VC firms provided by Business Finland the default non-disclosure period is 10 years. Breaking the agreement during this period results in a pre-determined financial penalty[152] and when a disagreement about the violation of the NDA arises and is not reconciled through negotiation it is taken to arbitration.[153]

[141] The more of its own capital the VC firm has in the fund the more risk-averse its actions become. By risking too much of the fund's capital it might not go for the same high-risk high-return ventures that the investors want since for them it is just a fraction of a portfolio but for the VC firm the future of the firm depends on investments.
[142] Ning and Wang 2017
[143] Icebreaker.vc
[144] Named Icebreaker Fund I Ky (Limited Partnership)
[145] Now Business Finland
[146] To see the full breakdown check Appendix A
[147] Start-ups are found through networks, events, incubators, hubs and by simply doing research into different databases or news articles.
[148] With start-ups that are science-heavy, like life science companies, the due diligence can take months because the VC firm's scientists test the hypothesis.
[149] E.g. cash-burn, previous investments, revenues, cost-structures.
[150] Maloney et al. 2011
[151] Especially a sensitive case when the start-up is dealing with CVCs since the potential investor is also your competitor. As apparent in the case of Amazon's Alexa Fund investing in DefinedCrowd and launching a competing product allegedly based on the information gathered through the due diligence process.
[152] Or a larger sum the wronged party is able to prove as the actual financial damage inflicted.
[153] Business Finland "Salassapitosopimus"

When the due diligence is completed and the company seems like a good fit for the fund, the negotiations start. When the details are agreed upon, they are formulated in the investment agreement between the fund and the target company. Through the negotiations the VC firm and the start-up attempt to find a valuation that enables the start-up to receive enough capital to reach the goals they set with the VC without losing too much equity themselves. Typically, the investment agreement holds, besides the valuation, a set of representations and warranties, protections for investors[154] and a limitation of liability.[155]

As the start-up is most likely a limited liability company, the investment by the fund is done through equity financing. Shares are issued by the start-up for the fund[156].[157] The shares the start-up issues are new and they dilute the ownership of current shareholders in the company. It is a red flag for the VC fund if the entrepreneur is trying to exit, in any way, in the early stages when the fund is joining the journey like by selling their own shares instead of issuing new ones.[158]

The valuation of the start-up is something that is a challenge for VC firms. The start-ups are often very early stage and traditional financial methods[159] used in PE or when investing on the stock exchange are not applicable. The value of start-ups is not based on their sales or the ability to pay dividends but rather on intangible assets like patents, the idea or the expertise of the entrepreneur. Basically, assets are priced that are hard to put a price on beforehand without a lot of assumptions[160]. It is no wonder VC valuations are seen more as an art than an exact science.[161]

[154] Examples of these protections: restrains of trade for founders and key employees, liquidation preference, anti-dilution protections, right to participate pro rata in future equity raises and offers of shares for sale, tag along rights, exit or liquidity rights, board appointment rights, reserved matter/veto rights and information rights.
[155] Krogerus 2013 Presentation
[156] To most often gain a minority non-controlling stake in the company.
[157] Chapter 9 of the Limited Liability Company Act
[158] FVCA 2018 "Näin haet pääomasijoitusta -opas yrittäjälle"
[159] Discounted cash flows or comparable multiples for example.
[160] These intangible assets are looked at through the lens of rather measurable estimations like time-to-exit or cash-burn. These help the VC firm estimate the amount of dilution they will have to experience before they can cash exit their investment.
[161] Maloney et al. 2011

Once an investment is made by the fund, the process of growing the business for the exit starts. During this period, the VC fund gives advice and assistance to the start-up through a board seat which is often a requirement set out in the investment agreement.[162] A not so encouraging statistic for this part of the VC firm and start-up partnership journey is the fact that the protection of minority owners is seen as especially weak in Finland. GII ranks Finland 60th globally in minority owner protection. The rank is below all three African nations covered in the thesis.[163]

The power within a Limited Liability Company is based on the principle of majority rule[164]. For protection to work minority shareholders need to react to the abuse brought on by the actions of the majority. The protection of minority shareholders, in this case, the VC firms, can be divided into automatic "passive" protection and "active" protection. Passive protection arises from the principle of equal treatment of shareholders, obstructionism provisions, procedural provisions for capital distribution and acceptance of measures undertaken by shareholders. Active protection requires often requires the minority shareholder to use their voice in the shareholder meeting and make a request[165] based on the Limited Liability Companies Act or the company's bylaws.[166]

During the period of active ownership, no major legal changes to the relationship happen unless there is conflict and the minority owner utilizes one of the above-mentioned methods or the VC fund extends further capital through further equity financing or by giving a bridge loan to reach a milestone. The bridge loan can in a few forms, it can be a debt-to-equity loan[167] or just a traditional loan.[168]

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[162] Pankkiiriliike Evli Oy 2001
[163] WIPO 2020 "Finland"
[164] The power of 50%+ of the votes trumps the rest. The defence of equal treatment is more a restrictive force on the majority than a power of the minority.
[165] The right to once request that a matter concerning the approval of the annual accounts of the annual general meeting and the use of profits be transferred to an extension meeting, right to demand an auditor, right to require special inspection, right to demand the distribution of minority dividends, right to demand that the merger be decided at the general meeting, the right to demand that the split be decided at the general meeting and the right to pursue an action in the name of the company in favour of the company if it is probable at the time of the action that the company itself will not take care of the execution of the claim for damages.
[166] Pönkä 2014
[167] Though the typical purpose of using debt-to-equity is kind of useless in VC since if the project succeeds the company will get equity and, in most cases, if the project fails there is no capital left in the company to pay the debt. So all roads lead to equity. But often the reasoning is that additional equity worsens the internal rate of return and dilution might not be welcome after a certain point.
[168] Ibrahim 2013 and Starting Up -course at Aalto University (starting-up.org)

When a company becomes one of the lucky 35% of companies in the VC fund's portfolio that survive the 10-year run-time of the fund it is time for the VC firm to exit its position. In Finland 52% of exits happen by trade sale, 11% by IPO, 24% by sale to another PE/VC firm and the remaining 13% of exits fall into various categories[169]. The most common method, trade sale, is a pretty straightforward sale of the VC fund's shares to a company most likely working in the same industry looking to buy innovation instead of investing in R&D[170]. The purchase is performed by a sale of shares currently held to the party barring possible lack of consent from current shareholders (if the clause has been agreed on) or one of the current shareholders exercising their redemption right (also needs to be agreed on) for the shares.[171] The exit by sale to another PE/VC firm works in a similar manner, just the purpose for purchase is different and the start-up stays independent instead of being most likely integrated into a new company through a trade sale.

IPOs are the holy grail of exits because they bring the highest returns for the VC funds out of all the exit methods. If the IPO happens before the fund needs to be liquidated the fund typically waits with a major holding of up to 75% of their initial investment until they need to liquidate to maximize their return and build their credibility as a fund in managing start-ups.[172] Another important reason for the VC fund to stick around through the listing is the positive impact this has on the value of the firm to new investors. The VC fund has advised the firm along its path towards the IPO which shows a track record of good management and compatibility, losing this devalues the company.[173]

In Finland, the IPO method of exit is less common than in the rest of the Nordics[174], especially in comparison with Sweden which has an active micro and small-cap market.[175] To quantify the difference we can look at IPOs of the First North Market[176] in 2020 by country[177] Sweden had 42 IPOs, Denmark 11 and Finland 3.[178] To go public in Finland there are

[169] For example, repurchase by the start-up's management
[170] Other reasons could be the purchase of the IP, buying out competition or expertise of the team.
[171] Pajarinen et al. 2016 and Chapter 3 Sections 6 to 8 of the Limited Liability Companies Act
[172] Neus 2005
[173] Jeppson 2018
[174] Finland 11% of exits are IPOs vs. 14% in Denmark, 18% in Sweden and 14% in Norway
[175] DVCA et al. 2018
[176] A market ”enabling Nordic and international entrepreneurs to access growth capital to develop and expand their businesses” (https://www.nasdaq.com/solutions/nasdaq-first-north-growth-market)
[177] Norway does not have a First North Marketplace.
[178] Nasdaq 2020

certain requirements the enlisting company needs to fulfil.[179] The requirements to list on the First North are less stringent with less mandatory disclosure, lower capital requirements and no required track record of financial statements than in the main Nasdaq market. First North has a low enough bar for basically an idea to be listed as long as there is sufficient working capital for 12 months.[180] Even with the option of the easier listing through First North, Finnish start-ups and VC funds seem to prefer the exit method of selling the shares outright to a third-party company. There could be a myriad of reasons for this: the costs and risks associated with listing, the need for the VC firm to stick around through and after the listing or the fact that VC firms enter and leave companies in Finland, on average, so early that IPO does not even come into consideration.[181]

If the start-up is one of the 65% that experience failure the VC fund will have to deal with insolvency of the target company. Failure is part of the start-up culture, even sometimes celebrated to dispel the fear around it.[182] Using the GII ranking again as a reference, Finland is ranked number one globally in the "ease of resolving insolvency".[183] The fallout for the VC fund is more financial than causing any processes or responsibilities. Once the start-up or its lenders successfully apply for bankruptcy the VC fund makes a write-off in the value of the capital invested in the start-up and moves on.[184]

All the successful exit routes mentioned in the earlier paragraphs work into the average TVPI of the Nordics of 1,2 which is higher than the European average of 0,7[185].[186] The average 20% return[187] is paid out using the standard "2 and 20"[188] rule. The 2 represents the 2% annual management fee on the invested capital by the limited partners which can be taken of the principal or charged separately[189] and the 20 represents the 20% cut the fund takes

[179] Pörssisäätiö 2016
[180] Nasdaq and Hannes Snellman 2019
[181] See Talouselämä 2018
[182] See Koskinen 2020
[183] WIPO 2020 "Finland"
[184] PwC and FVCA 2006
[185] Every euro put into VC in the Nordics gives €1,2 back and in Europe €0,7 (a €0,3 loss on each euro put in). TVPI is the best way to measure PE or VC returns and unfortunately, the data is from 2015. But it gives an indication of strong performance in the Nordic's.
[186] DVCA et al. 2018
[187] Which is way below the TVPI of 3 expected by investors.
[188] With some variations
[189] Based on what has been agreed in the investment agreement.

from the profit[190] it manages to generate over an agreed-upon hurdle-rate. The hurdle rate is the minimum return that the investors expect on their capital from the VC firm managing the fund.[191] The hurdle-rate depends on myriad factors from the riskiness of the investment mandate to the previous track record of the fund managers. It is often in the 0-10% range.[192]

The final step to cover in the legal life of the fund is the unavoidable, taxes. From a VC fund point of view, it is quite simple: if the fund is a limited partnership the fund is looked through and treated as an accounting unit with the taxation happening at the level of the partners after the capital has been allocated.[193] Taxation is one of the reasons limited partnership are so popular; they create a clear division between the investors and the active fund managers when the time comes to divide the loot.[194]

The VC firm, in the form of a limited liability company, managing the fund as a general partner treats the management fee and the post-hurdle-rate profit share as revenue which gets taxed at the corporate tax rate of 20%. The limited partners, in the same way, deal with taxes as if they would have invested straight in the underlying companies with the rate of tax depending on the form in which the profit is distributed back: dividends, interest or the sale of shares. The process gets a bit more complicated with foreign investors when withholding rates have to be taken into account and double taxation might become an issue.[195] Although this does not seem to be an obstacle for foreign investors who now make up 62%[196] of invested capital in Finland. The attraction of foreign capital in recent years has made Finland the number one nation in Europe for VC investment[197] as a % of GDP. The taxation impact on VC funds and firms investing in Africa will be covered in the later chapters concerning the individual nations.

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190 For example, if a €100mil fund is at €180mil when it is time to liquidate: the fund has received €20mil in management fees (€100mil*2%*10years) and €8mil in profit share from profit above the hurdle rate of 40% on the €100mil ((€80mil-€40mil)*20%) for a combined total of €28mil and the limited partners receive the rest (€152mil).
191 CFI 2021 and Paasi 2014 (Nordnet)
192 Buzzacchi et al. 2015
193 Section 6(4) of the Business Income Tax Act
194 PwC and FVCA 2006
195 Johansson et al. 2011
196 FVCA 2020 ”H1/2020 Finnish Private Equity Activity: Venture Capital”
197 FVCA Press Release 2020

3 Venture Capital in Africa

3.1 Current Level of Investment

The composition of the external capital flows into the African continent has experienced a shift in the recent decade. Foreign direct investments have overtaken remittances[198] and official development assistance as the major source of capital.[199] The shift is the result of strong economic growth in the region. It has expanded the middle-class consumer base making the continent more attractive for businesses.[200] VC activity in Africa has grown in symbiosis with the economy, expanding and helping generate even more innovation and bolstering further growth.[201]

One metric that showcases the growth Africa has been experiencing is the increase in the value of total VC deals in recent years. In 2014 $0.4bn VC was invested in Africa. Five years later the same figure is $1.4bn representing a CAGR of 28%. The $1.4bn has four major geographical targets: 21% of the capital goes to companies headquartered outside of Africa with the capital going towards African expansion, 21% to South Africa, 18% to Kenya and 14% to Nigeria.[202] Later chapters will uncover the reason why these countries attract over half of the invested VC[203].

Start-ups are a reflection of what challenges society faces and in Africa, the industries that attract the most investment are more capital intense than the top industries in the EU, US or Finland which are more high-tech focused. The distribution of capital invested by industry in Africa is different to the US, EU and Finland.[204] Consumer Discretionary is the leading industry in Africa attracting 28% of VC followed by Fintech (23%) and tight third and fourth places are occupied by Industrials (18%) and Utilities (17%).[205] This distribution of favoured

[198] Money sent home by an emigrant.
[199] Sy 2015 (Brookings)
[200] African Development Bank 2020
[201] AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”
[202] ibid
[203] When you take into account that 53% goes to the countries covered in the thesis and another 21% goes to firms headquartered outside the continent this leaves 26% of invested capital for the rest of the countries out of which Ghana and Egypt are another 13% leaving 13% of the $1.4bn, $182mil, for the remaining 49 countries on the continent.
[204] To see the industry division of these geographic areas see Figure 1.
[205] AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”

VC investment target industries showcase some of the structural challenges the continent is still facing.[206]

The deal volume to capital invested ratio confirms the thesis of Africa needing capital heavy investments in the VC space. ICT is 19% of the deal volume but only 6% of capital invested which shows high activity but a relatively low cost of acquisition and thus operation. In comparison, industries like utilities, industrials and consumer discretionary attract a combined 53% of invested capital but just 43% of deal volume. The same goes for communication services which are only 3% less in deal volume (8%) than utilities (11%) but receive just 3% of VC.[207]

An industry that most reflects the challenges that Africa faces is fintech. A continent where traditional banking has a very weak reach but mobile phone adoption is high creates an opportunity for innovative fintech solutions. In 2011 Sub-Saharan Africa had the largest share of unbanked and underbanked population globally.[208] Six years later Africa had the largest share of population with mobile money accounts[209] globally.[210] M-Pesa, founded and currently owned by Vodafone and Safaricom[211], paved the way for Fintech with its mobile paying platform that handled over 12 billion transactions[212] in 2019.[213]

Countless competing fintech start-ups have launched across Africa in recent years, filling the gap left by traditional banks, attracting large amounts of VC. Most notable examples of this are the Nigerian fintech start-ups OPay, Flutterwave and PalmPay raising a combined almost $300mil[214] in VC.[215] OPay and PalmPay have quite similar stories: both are Lagos-based, both were founded in 2019 and both received funding[216] and incubation from China.[217] The power of Fintech, enabling people to start saving and being fiscally responsible, has and will play a key role in the acceleration of African development.

206 See Spender et al. 2017
207 AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”
208 World Bank 2014 ”Global Findex 2014”
209 Over 20% estimated compared to the global average of 2%.
210 World Bank 2017 ”Global Findex 2017”
211 Largest mobile operator in Africa
212 To put this in context Klarna handled 365million transactions in 2019.
213 Vodafone 2021
214 To put this in perspective it is double the total capital invested in the Finnish VC market in 2019.
215 Crunchbase ”Flutterwave”
216 OPay $170mil and PalmPay $40mil
217 Crunchbase “PalmPay” and Crunchbase ”OPay”

The distribution of funding of start-ups in Africa by stage of investment is quite similar to Finland: about a third of all VC deals went to seed stage companies from 2014 to 2019.[218] Also, 65% of the investment rounds in Africa were below $5mil so even with mostly capital heavy industries receiving the funding VC funds are joining the game with relatively small investments so the barrier to entry from a financial standpoint is modest.[219]

A factor that differentiates African VC from others globally is the share of investments coming from impact funds. From 2014 to 2019 44% of deals had at least one impact investor[220] as part of them.[221] VC impact investing is on the rise. As social and environmental challenges are rising priorities in society firms are taking the principles and practices utilized in VC to create positive change and a risk-adjusted financial return[222] and what better place to do it than in Africa, where every investment is an impact investment.[223]

3.2 Geographic Division of VC Investors in Africa

3.2.1 African Firms

The birth of VC in Africa can be attributed to the founding of the Johannesburg Venture Capital Club in the mid-1980s. The members were local law firms, PE managers, the Industrial Development Corporation[224] and various other businesses. The first government-backed VC fund of Africa, Technifin[225], was also established in South Africa a few years after the Venture Capital Club in 1992.[226] The 1990s are seen as the time in Africa when VC got more established through mostly domestic and foreign governmental efforts like Technifin or the New Africa Opportunity Fund for South Africa by OPIC[227] with the goal to assist small business growth and stimulate the economy.

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218 AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape” and FVCA 2020 ”H1/2020 Finnish Private Equity Activity: Venture Capital”
219 AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”
220 In Finland, 58% of funds say they take social and environmental impact into consideration and 87% of funds believe that it does not affect their profit but there are only actually a few funds that are categorized as impact investors. (FVCA Press Release 2019)
221 AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”
222 Cetindamar and Ozkazanc-Pan 2017
223 Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
224 A fund established in the 1940s to fund small and medium enterprises of the Afrikaans community to combat poverty.
225 Was in operation for two years after which its portfolio was transferred to the South African Inventions Development Corporation.
226 Lingelbach et al. 2009
227 Now known as DFC (https://www.dfc.gov/). An American governmental development finance institution.

The main catalyst to all this happening in the 1990s was the change of approach to financial aid globally. Equity investing was seen as a better way to support development than loan-based financing. Equity-based investing incentivises better support for the businesses. Through equity financing, the investors become equals with the business owners and align the interests of both parties. It incentivizes the investors to maximize profits of the enterprise over the long term, not just get their principal and interest back which was the old model of debt-based financial aid.[228]

The first private African domestic VC funds started popping up in the mid to late 1990s like the firm Africinvest[229] which was founded in Tunisia in 1994 or the Nigerian African Capital Alliance founded in 1998. As Africinvest started broadening its investment horizon to other North African countries it helped found The African Private Equity and Venture Capital Association in 2000.[230] AVCA, much like FVCA, promotes and enables VC investment in the region through education, research and networking.[231]

Private financing in the African start-up ecosystem in the 1990s and late 2000s was dominated by foreign investors with most of the capital being impact investments. In more recent years, for-profit VC funds founded on the continent have been growing their presence. From 2014 to 2019 20% of the investors participating in VC deals came from one of the 54 African countries.[232] Out of these African VC funds, South African investors are the most active with 9% of investments followed by Nigerian investors at 4% with Egypt being third at 2%.[233] Another testament to the rise of African VC firms has been the fact that three out of the six most active dealmakers from 2019 to H1 of 2020 were domestic VC firms: Novastar Ventures[234], Algebra Ventures[235] and CRE Venture Capital[236]. Combined they were part of 32 deals in the 1.5-year period measured. [237] The only firm that made more deals in Africa than

[228] AVCA 2018 ”An Untold Story: The Revolution of Responsible Investing in Africa”
[229] $1.7bn AUM with over 160 companies invested in across 25 African countries. A partner of the firm, Khaled Jilani, was one of the African investors interviewed for the thesis to find solutions to the obstacles.
[230] AVCA 2018 ”An Untold Story: The Revolution of Responsible Investing in Africa”
[231] AVCA 2021 ”About”
[232] AVCA 2020 ”Venture Capital in Africa: Mapping Africa’s start-up investment landscape”
[233] Irwin-Hunt 2020 (FDI Intelligence)
[234] Kenyan firm, Novastarventures.com
[235] Egyptian firm, Algebraventures.com
[236] South African, CRE.vc
[237] EMPEA 2020 ”Africa Mid-Year 2020”

the number two, Novastar Ventures, was 500 Startups, the world's most active VC firm of the year[238] for the second year running.[239]

3.2.2 Global Firms

The attitudes of global firms towards Africa is changing. With the population growth and economic development Africa is experiencing, funds do not want to miss out on the opportunity of getting into the market early. Also, as many of the countries have become more pro-business and democratic funds are more comfortable making investments on the continent. This has led to the fly-in, fly-out model slowly disappearing and global VC funds setting up offices in Africa to be closer to the start-ups and capture more of the local talent. When funds decide to venture into Africa, they have many ways to approach the ecosystem with some funds taking the generalist approach while others focus on a certain country or industry.[240]

Currently, the 80% of global VC firms that invest in the region are almost a microcosm of the distribution of VC funding globally. From 2014 to 2019 the space has been dominated by US founded firms with 40% of total investments. Though 40% might seem like a lot it is still below their 50% market share globally.[241] The reason for this lower share of US capital is the heightened activity of Chinese VC funds in Africa in recent years. In 2019 Chinese funds represented 18% of invested capital[242] followed by the UK at 8%.[243]

With 40% of total investments, US VC funds are drivers of the start-up space on the continent. Distinguished top US VC firms have led the way. Firms like 500 Startups or Accel have started monitoring and investing in Africa in recent years more actively. 500 Startups has been quite true to their name with already 71 active VC investments in ten different African countries.[244] CVCs have also shown their growing interest in the region by more frequent visits and infrastructure investments.[245] Google recently opening an AI research

[238] 285 investments in 2019 out of which 20 were made in Africa. The firm also made the most exits in the world in 2019 with 41 exits, 31 of which in the US.
[239] GlobeNewsWire 2020
[240] AVCA 2014 "Guide to Private Equity in Africa"
[241] Lerner and Nanada 2020
[242] Digest Africa 2020
[243] Irwin-Hunt 2020 (FDI Intelligence) Though Japanese firms were mentioned earlier, their impact on the market is yet to be seen in the data since the move has been very recent.
[244] 500 Startups 2021 "Portfolio"
[245] Shapshak 2019 (Forbes)

centre in Ghana and an accelerator program for African start-ups are a great example of this.[246]

China's VC firms' interest in Africa has deepened as a result of the One Belt One Road initiative[247].[248] A statistic that shows the exponential growth of Chinese VC flooding the African market is the fact that 2% of total investments in Africa came from China between 2014 and 2019[249] but when looking just at 2019 China already represents 18% of invested capital.[250] When Chinese VC firms invest, they invest big; three out of the six largest investment rounds in 2019 came from Chinese VC firms.[251]

UK based firms being third at 8% of participation from 2014 to 2019 in VC is higher than their global average of 5,1%.[252] UK's relationship with Africa is unique since many of the target countries are former colonies with UK's cultural and legal imprint still part of their business structures making investing in the region easier.[253] As an example one of the UK's best known VC firms, Playfair Capital[254], has opened a fund to invest in Africa with the founder[255] moving to the continent to support the fund better in its journey into the "frontier markets".[256] As evident from this chapter these "frontier markets" seem to be attracting growing interest from investors globally with the acclaimed firms from the largest VC countries making the first moves.

3.2.3 Finnish Firms

The small amount of material found for this chapter shows just how untapped of a market African start-ups are for Finnish VC firms. Currently, VC investment activity into any

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246 Google Blog 2018 and Google Startup 2021
247 Revealed to the world in 2013 and also referred to as the New Silk Road, the OBOR is an infrastructure investment project stretching from China to Europe. Through investing in railways, energy pipelines etc. between China and Europe OBOR is creating a more globally connected China. Critics of the initiative say it is a borrowing trap for developing governments with a goal for China to extend its political power globally through using debt as leverage to influence countries along the OBOR into political submission.
248 See Ehizuelen 2017
249 AVCA 2020 "Venture Capital in Africa: Mapping Africa's start-up investment landscape"
250 Digest Africa 2020
251 EMPEA 2020 "Trends In Global VC+Tech EMPEA's Inaugural Report On Venture-Backed Startups Across EM"
252 Graham 2019 (TopTal)
253 See Murray-Evans 2016
254 Playfaircapital.com
255 Federico Pirzio-Biroli
256 Cook 2016 (BusinessInsider)

emerging markets is minimal but as discussed earlier that was a major motivator behind this thesis to figure out why this is the case and what can be done for it to change.

Currently, almost a third[257] of VC invested by Finnish firms goes outside of Finland.[258] To break this number down further: 89% of Finnish VC firms invest outside of Finland, 41% invest outside the Nordics and Baltics and 30% invest outside of Europe[259]. Interestingly, size does not correlate with more geographic outreach. It seems to be more the generalist vs. specialized approach that divides the firms' willingness to seek targets globally. When you know an industry inside out, as a specialized VC firm, it makes less of a difference from where you source your investments. Since the goal of a start-up is to go global and your potential target companies are fewer and further between than for generalist firms. Being geographically picky in that case does not add value for the investors.[260]

The closest thing to a Finnish VC firm actively investing in Africa is FinnFund. FinnFund "is a development financier which builds a sustainable world by investing in responsible and profitable businesses in developing countries" financed by the Finnish government.[261] The latest annual review of FinnFund highlights the fact that almost half of their portfolio targets are in Africa and they expect to see further strong interest and growth in the region. A great example of a FinnFund investment in Africa that would meet the criteria of a VC investment is Sanergy[262]. Sanergy is a Kenya-based start-up into which FinnFund invested €1mil as part of its Series A in 2016.[263] Following this, Sanergy has received over €11mil in funding to date from all over the globe and serves almost 100,000 customers daily. In 2020 Sanergy closed a Series C funding of €2.5mil from AXA[264].[265]

Another FinnFund investment target, Fuzu, is the only investment in Africa that has Finnish VC behind it. Fuzu received €3.4mil Series A funding from Sparkmind[266] in 2020 and

[257] 28% in 2019, 27% in 2018 and the yearly average since 2007 is 20%
[258] FVCA 2020 "H1/2020 Finnish Private Equity Activity: Venture Capital"
[259] Though mostly this means the US.
[260] Manually going through every Finnish VC firm in the FVCA Members page (https://paaomasijoittajat.fi/en/fvca/members/#jasenet)
[261] Finnfund 2021
[262] A Kenya-based start-up providing "non-sewered sanitation solutions that serve all urban residents and are 5 times cheaper than sewers" (http://www.sanergy.com/)
[263] FinnFund 2020
[264] A French insurance company with over €100bn of annual revenue. (https://www.axa.com/)
[265] Crunchbase "Sanergy"
[266] A Finnish VC firm focused on the learning sector which goes to prove the point that specialists are more willing to cast their nets globally. (https://www.sparkmind.vc/)

FinnFund had invested €1.8mil of Seed Capital in 2016.[267] Fuzu is a "one stop shop for the largest selection of open jobs, insights into the East African job market[268], tailored career advice and skill training."[269] To classify Fuzu as a strictly African start-up is hardly possible since Fuzu has two Finnish founders and is currently domiciled in Finland though all of its operations are in the African market even receiving Kenyan VC[270] early on to support expansion.[271] This fusion venture and FinnFunds efforts will hopefully be the trailblazers paving the road for many more investments and start-ups on the continent with active Finnish ownership.

3.3 The Investment Process in Africa for a Finnish Firm

This chapter will cover the process of VC investing in a foreign country. By going through the process step-by-step as in Chapter 2.3.3. The chapter will highlight the differences and the inevitable challenges that come with cross-border investing.[272] Chapter 4 will then build on and supplement the investment process laid out providing specifics e.g. the taxation levied on profit. The chapter is written from the point of view of a Finnish VC that would invest in Africa.

The first few steps for a hypothetical firm wanting to invest in Africa are similar to those covered in Chapter 2.3.3. The VC firm sets up a limited partnership in Finland and finds investors for the fund as limited partners. The differences start when the fund is up and running with sufficient capital ready to invest.

The first decision a VC firm venturing to Africa needs to make is the type of vehicle used for investment and what kind of local support it requires. There are countless possibilities of setting up "vehicle structures" to reach the target start-up from the Limited Partnership.[273] The factors that influence the decision on what kind of a structure to use are taxes, costs, ease of exit and risk.[274]

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[267] Crunchbase "Fuzu"
[268] By 2040 Africa is expected to have the largest global job market.
[269] Fuzu 2021
[270] From the firm Cornerstone Enterprises with a 5mil portfolio of investments.
[271] Sparkmind.vc 2020 Press Release
[272] Mäkelä and Maula 2008
[273] This could be a thesis topic in itself.
[274] Ndemo and Weiss 2017

Taxes are country-specific so they are better covered in the individual country profiles but simply put: if the firm wants to minimize the tax burden and avoid double taxation the treaty network of the start-up's domicile country determines what type of structure is optimal.[275] For example, the start-up's domicile country might not have a bilateral tax treaty with Finland so opening an investment vehicle[276] in Luxembourg[277] that the VC firms Limited Partnership owns 100% of for its investments outside of Europe might be the best solution. The €9bn invested in VC through these Luxembourg fund vehicles might attest to their suitability.[278] Although it is important to remember that the more subsidiaries the fund opens the more complex, especially the exit, and costly the operation becomes.[279]

After the appropriate form of reaching the chosen African market has been established the VC firm needs to figure out what type of, if any, local support it requires. To navigate the new ecosystem hiring at least a local lawyer for assistance early on is advised. On top of that getting in touch with incubators, investor networks and local research firms will help the VC firm form a better information base of the new landscape. More involved, and costly, support can be received from consulting firms[280] that specialize in advising investments in emerging markets. They provide experience and current market insights that can save a VC firm a lot of trouble and capital as it ventures out to Africa for the first time.[281]

When the choice of a partner is made, the sourcing of an investment target begins. The abovementioned partners, especially incubators and investor networks are of great help at this point if the VC firm has not ventured out with a specific firm in mind. Another option for finding an investment target is partnering with a local VC investor. Having a "home" investor as part of the deal process gives it a stamp of approval with local knowledge[282] and

[275] Cockfield 2010
[276] There are four main vehicles in Luxembourg for VC: Special Limited Partnerships (basically a limited partnership with more contractual freedom and flexibility), SICARs (a vehicle specially designed for risky VC investment), Reserved Alternative Investment Funds (offer a non-regulated version of the SICAR) and The European Venture Capital Fund (created for VC firms that want the EU label and can market their fund with it).
[277] A country with an extensive tax treaty network making it a perfect domicile for investment vehicles.
[278] DLA Piper 2019
[279] See Ndemo and Weiss 2017
[280] For example: CrossBoundary (https://www.crossboundary.com/), African Venture Advisors (https://african-venture.com/), GreenTec Capital Partners (https://greentec-capital.com/) and AfricaDev Consulting (http://africadevconsulting.com/).
[281] See Global Impact Investing Network and Open Capital 2015
[282] Although local market knowledge and contacts are not that important in the start-up space since rapid internationalization is the goal.

with both having equity the goals are aligned creating a good base for collaboration. Besides the stamp of approval, the local VC is able to alleviate frictions that might arise from cultural differences when investing or during active ownership of the investment.[283] Research into other emerging markets shows that VC investments done in partnerships are more likely to reach a successful exit.[284]

The due diligence process for evaluating target start-ups for investment is not radically different when investing in Africa. The firm still gets to practice its valuation art with its internal requirements and models the same way it would analyse a local start-up. Like with finding the targets for due diligence the mentioned local partners help close gaps of information asymmetry and cultural disparity in due diligence too.[285]

The actual act of investing is determined by the domicile of the start-up and the vehicle chosen for investment. As the valuation and equity stake is negotiated the tactics used might feel confusing and foreign for both parties involved[286] assistance from a local lawyer at this point is vital. The minimal assistance required is related to drawing up the contract and guiding the parties through the potentially differing norms.[287] All three African countries focused on in this thesis have a common law legal system with English origins which differs in its approach to contracts. They are much more narrowly construed and precise leading to much more complex and lengthy documents that leave little to interpretation.[288]

The active ownership stage is the point at which political risk and the risk of a weak legal system can materialize in emerging markets. The political and regulatory spaces play a big part in forming what is referred to as an entrepreneurial environment.[289] Political risk brings with it the potential for sudden unfavourable and discriminatory policy changes, instabilities like war or political violence, currency issues[290], restriction of vital resources for the start-up or even expropriation or nationalization.[291] As political risk clearly can affect the start-up's chances of success a correlation in willingness to invest and the stability of the political

[283] Mäkelä and Maula 2008
[284] See Dai et al. 2012
[285] Ibid
[286] See Gunia et al. 2016
[287] Asongu 2011
[288] Arnold 2007
[289] See Khoury et al. 2012
[290] Devaluation through hyperinflation or inconvertibility of currency.
[291] Luo and Junkunc 2008 & Bonini and Alkan 2011

environment has been found.[292] Although as a counterpoint, there are certain start-up industries like software where the firm could be based anywhere and there are no physical revenue-generating assets to worry over, except the human capital, so an unstable political environment should not affect the valuation and potential of these firms in the same manner as it does for example for an early-stage biotech company. This makes tech VC investing more resilient to the environment and there should be a lower threshold for VC investments than for larger FDIs from a legal and political risk angle.

The legal system of a country also affects the transparency, management and predictability of transactions. The main concrete legislatorial areas affecting VC firms investing in foreign markets are: governance structure of a firm, rules on bankruptcy, regulations governing creditors, IP protection, minority protection and taxation all of which will be covered in the country profiles since, as with taxes, the heterogeneity of legislation in these areas across Africa requires country-by-country analysis.[293]

A potentially unifying fallout factor of weak legal systems across emerging markets are transaction costs and unpredictable informal institutions born to plug the holes left by weak or inept governmental institutions.[294] The transaction costs that might mount in emerging markets are born from uncertainty.[295] This leads to the incentive for VC firms to invest more capital at once in uncertain markets rather than in tranches, as is normally the practice in VC. The invested sum in total is also smaller than in an equivalent start-up in a steadier environment.[296]

Firms investing in emerging markets must protect themselves in transactions more thoroughly since the remedies for misappropriation of invested funds or investments made on false pretences might be non-existent or too costly to be applicable.[297] Most of the covering happens ex-ante through due diligence and good networks rather than ex-post through legal procedure. Although interestingly one of the most famous cases of abuse of power on the continent is the case of minority control abuse in Emerging Capital Partners, a US PE firm,

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292 Bonini and Alkan 2011
293 Judge et al. 2008
294 Ahlström and Bruton 2006
295 See Barasa 2018
296 Utset 2002
297 Khoury et al. 2012

vs. Spencon, a Kenyan construction company. The foreign PE firm was allegedly able to take control of the entire Kenyan company through financial manoeuvring in the attempt to flip the company for a profitable exit, so the risk runs both ways.[298]

Arbitration is often touted as the solution for investing in riskier markets where ex-post legal remedies are insufficient. Unfortunately, in the VC world of emerging markets investments are relatively small in comparison with the costs associated with solving the matter through arbitration[299] and even when solved the collection of damages is unlikely. The damages need to be recouped from a start-up with most likely very limited financial means using the legal system which was circumvented by arbitration in the first place.[300]

Another danger investors need to take into account in developing countries is the level of IP protection provided by the country of the start-up's domicile and target markets. The globalisation of business has required a unified approach to IP protection incentivizing countries; strong IP protection will bring business and investments and weak protection will scare market actors away. As part of the due diligence process, the VC firm must analyse what kind of protection will be needed for the start-up's outputs.

Some start-ups, where the product is brand-based and physical, need strong legal protection. For example, a clothing or electronics company will have trouble cashing in on its success if the measures to stop counterfeit and copycat products are unavailing. Other types of businesses survive and thrive just on informal protection methods like keeping the "recipe"[301] secret or simply by utilizing the first movers' advantage to keep the market.[302] African countries have had very different approaches and levels of success thus IP protection will also be covered as part of the country profiles.[303]

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[298] Barnwell Enterprises Ltd *v.* Emerging Capital Partners, Misc. No. 2016-2581 (D.D.C. 2017), cases in Uganda, Kenya and Mauritius still pending.
[299] The Stockholm Chamber of Commerce arbitration calculator (https://sccinstitute.com/our-services/calculator/) for example places the cost of arbitration for the average-sized VC investment in Finland (€704k) at around €50k
[300] Myburgh and Paniagua 2016
[301] Or most likely in the case of start-ups the code.
[302] See Amara et al. 2008
[303] See Mupangavanhu 2015

Informal institutions, born out of a weak legal and political system, are tough to tackle when coming into a country as a foreign investor, especially when coming into an unfamiliar business culture as would be the case for Finnish VC firms venturing to Africa. To navigate the world of informal institutions an investor needs a network of local assistance as already discussed in the paragraph on choosing the "vehicle" for investment. Informal institutions are gatekeepers to fluid business in the region. The difference in the practice of an informal institution and bribery or corruption might sometimes be hard to discern for a foreign investor again stressing the importance of good advisors knowledgeable in local ways of operation.[304]

The final step in the journey of a cross-border VC investment is the exit. Cross-border exits differ on a theory level in a few ways from domestic ones. Firstly, the time to exit is longer than in domestic exits, at least in comparison with the golden standard of US VC.[305] This longer time to exit in cross-border VC investments is due to factors such as level of legality and freedom of the economy.[306]Also in contrast with common belief, the local stock market does not affect the time to exit in cross-border VC investments although the legality is often tied to the quality of the local stock market.[307]

To contrast the statistics that make cross-border investment exits a bit harder to achieve is the validity of the convergence hypothesis[308]. The convergence hypothesis for economic growth was found to be true in research on cross-border VC investments in developing countries thus supportive of the idea to venture out into developing countries for faster growth.[309]

From a more practical standpoint, the same exit methods apply: IPO or one of the many equity deal methods. As discussed earlier, buyouts come most often from the current management, PE firms or companies within the industry of the start-up. In Africa generally exits are seen as one of the most significant challenges for start-ups. Currently, PE and other financial buyers represent 54% of total exits and trade sales 31%.[310] The impact of local law

[304] See Krammer 2019
[305] Espenlaud et al. 2015
[306] Wang and Wang 2012
[307] Cumming et al. 2006
[308] Poorer countries will eventually catch up to richer countries, so their current growth is faster than that of more developed countries. In the research regarding cross-border VC investments GDP per capita is found to be negatively related to the likelihood and hazard of a successful exit.
[309] Wang and Wang 2012
[310] AVCA 2020 "Private Equity & Venture Capital in Africa: Covid-19 Response Report"

and customs on specific exit routes will be covered also country-by-country in the following chapter.

As 85% of deals happen by the sale of equity in Africa, in most cases a VC firm will go through a process similar to the one of investing in a start-up by buying its shares. The specifics of the process depend on the type of purchaser and their domicile. As the share of foreign PE in Africa is large the purchases can become complicated international deals.[311] At this point, the local taxation, governmental incentives[312] and the choice of investment vehicle play a role in determining how the exit is structured and what costs arise because of it.[313]

In case the start-up fails, the local bankruptcy proceedings will come into play. The bankruptcy process and the strength of it also play into the general level of legality that was mentioned earlier and into the way creditors are dealt with in general[314]. Creditor protection and bankruptcy law, in general, is not that strong in Africa with a lot of informal processes and because there are vast differences among the continent's countries bankruptcy and creditors will be covered in more depth in the following chapter.[315]

As the chapter demonstrates there are no major differences in the actual process of cross-border investment to Africa. The firm needs to find a target, do the due diligence, invest, actively manage and exit just like it would in the Nordics or Europe but the magnitude of difference in the familiar steps is what makes the proceedings challenging and that is what the rest of the thesis will delve into. Firstly, analysing by target country the framework for investment building on top of the differences in the process highlighted by this chapter and then looking at it through a lens of a Finnish VC firm through interviews.

311 Babarinde 2012
312 At this stage tax breaks mostly.
313 Biekpe 2004
314 For example, as a start-up with cashflow concerns, a refusal of payment by a customer can drive the start-up financially into hot water especially when there is a lack of official routes to pursue the rightful payment.
315 See Tchamyou and Asongu 2017

4 The Readiness of the Chosen Countries for VC Investment

4.1 Nigeria

4.1.1 Overview

Nigeria has a tumultuous history. It was a British colony from 1852 receiving independence in 1960 sparking civil wars over control of the then dubbed "African Giant" because of the petroleum reserves found in 1958. Corruption and conflict have marred the development of the nation since.[316] Corruption is seen as the largest obstacle preventing Nigeria to reach its full potential[317] with its Corruption Perceptions Index rank stagnating in the bottom 25% globally since the beginning of the index in 1995.[318]

Despite the challenges, Nigeria has grown into an economic behemoth of Africa. It has the largest GDP[319] (€367bn[320]) and the highest population[321] (206mil[322]) on the continent. A lot of its economic power stems from its abundant natural resources[323]. It is the world's 8th largest oil exporter with its economy heavily reliant on these exports: crude oil accounts for 10% of its GDP, 70% of the government's revenue and 83% of the country's export income. Services are the main employer (52%) and the main industry as a portion of the GDP (52%). The main subsectors for services in Nigeria are retail, telecommunications and the financial industry.[324] The country's stock market, founded in 1961, has 161 companies with a total market cap of €46bn.[325]

Nigeria's future outlook is a mix of unrealized potential and major challenges. Population growth and oil reserves fall into both categories. Nigeria's population is expected to surpass the population of the US by 2050 with almost 400mil inhabitants. The rapid population growth is causing housing, food supply and employment not being able to meet the needs of

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316 Falola and Heaton 2008
317 Campbell and Page 2018
318 Transparency International 2020
319 Statista 2021 "African countries with the highest Gross Domestic Product (GDP) in 2020"
320 Egypt is second at €300bn which is an over 20% gap.
321 Statista 2021 "African countries with the largest population as of 2021"
322 Almost double over second-place Ethiopia which has a population of 115mil.
323 Oil, liquefied natural gas, tin ore, coal, iron ore, limestone, niobium, lead, zinc and arable land.
324 Societe Generale 2021" Nigeria: The Market"
325 Nigerian Stock Exchange 2021

the citizens.[326] On the flip side Nigeria is estimated to be one of the few countries in the world by 2030 that will have its main demographic be young workers creating a strong human capital pool to build development on.[327] The second challenge/opportunity, depending on the view, for Nigeria has been its heavy dependence on oil exports. The dependence makes fluctuations in oil prices have an inordinately effect on its economy but on the flip side if the inflowing capital from oil exports would be put to project creating sustainable growth for the country Nigeria could develop rapidly.[328] All in all, the future of Nigeria could be bright with its enormous potential if the unfortunate political actions currently stymying growth are overcome.

4.1.2 Legal Landscape for VC Investments

As a former British colony, Nigeria has adopted a mixed legal system with a strong British influence. The four legal traditions fused to form Nigeria's legal space are English law, Common law[329], Customary law[330] and Sharia law[331].[332] The government's judicial branch exercises its power through federal courts with the Supreme Court of Nigeria being the highest court in the hierarchy.[333] The GII ranks Nigeria's regulatory quality and rule of law 122nd and 118th respectively out of the 131 countries measured.[334] The realities of the strength of the legal landscape need to be mirrored with the information in this chapter; what is stated as the law might be poorly enforced or non-codified informal processes might supersede it.

The acts that a Finnish VC firm would be most impacted by in Nigeria when investing in a start-up are the Companies and Allied Matters Act, the Nigerian Code of Corporate Governance, the Venture Capital (Incentives) Act and the Companies Income Tax Act. The fact that there is a specific act for incentivising VC speaks volumes for the potential Nigerian authorities see in attracting VC.[335] The Act itself incentivizes VC investments through tax breaks at both ends of the investment: a tax credit is received for the full amount of the principal, 0

[326] PwC 2019 ”Nigeria Economic Outlook”
[327] British Council 2010
[328] See Asalaye et al. 2019
[329] Common law doctrines and statutes were in force in England on the 1st of January 1900.
[330] Derived from indigenous norms and practices.
[331] Islamic
[332] Daniels et al. 2011
[333] Efobi and Ekop 2021
[334] WIPO 2020 “Nigeria”
[335] Marone 2019

to 100% of profits arising from an equity exit are taxed depending on the time-to-exit[336] and 50% of dividends paid to VC funds from ventures are tax-free.[337]

Sans incentives, the corporate tax rate is 30%[338] and dividends are taxed at 10%[339] in Nigeria. Finland has initialled a draft of a double-taxation agreement in 1990[340] with Nigeria but it has never been ratified.[341] Not having a tax treaty might seem unusual but in Nigeria's case, this is more than likely. Nigeria has currently only thirteen[342] active treaties.[343] The lack of a treaty bilateral treaty between Finland and Nigeria adds a layer of cost because companies will have to either create a subsidiary in one of the countries with a treaty or pay the full withholding tax of 10%[344]. Having a strong network of DTTs and other treaties is a cornerstone of a countries internationalization efforts so it is likely the network will expand with Nigeria's development.[345]

The structure and operation of potential target start-ups in Nigeria are governed by the Companies and Allied Matters Act and the Nigerian Code of Corporate Governance. Both are relatively new, with the Companies and Allied Matters Act being revised in 2020 and the Nigerian Code of Corporate Governance being introduced in 2019. The CAMA is an 870 section primary legislation governing the establishing and managing a business with the recent revision being part of the governmental efforts to ease commerce in the country.

From the point of view of a Finnish VC firm, the Nigerian Code of Corporate Governance would be of more interest since it would be the playbook for active management and protect the firm against potential abuse by the target start-up's other investors and directors. Before

[336] A five-year exit is not taxed, 25% gets taxed in a 6 to 10 years exit, 75% gets taxed in an 11 to 15 years exit and after that, the tax has to be paid in full. The system incentivizes a quick scale-up of start-ups which also ties in the VC firm more intensely because they are extra motivated to exit within five years since this makes the exit 43% more valuable (in comparison with an exit without the tax exemption for example in another jurisdiction).
[337] Venture Capital (Incentives) Act 1993
[338] Section 40 Subsection 1 of the Companies Income Tax Act 2007
[339] Section 80 Subsection 2 of the Companies Income Tax Act 2007
[340] Henri Telkki 2014 (Finnwatch)
[341] Vero.fi 2021 " Voimassa olevat verosopimukset"
[342] Belgium, Canada, China, Czech Republic, France, the Netherlands, Pakistan, Philippines, Romania, Slovakia, South Africa, Spain and the United Kingdom.
[343] PwC 2021 "Nigeria: Corporate – Withholding taxes"
[344] In comparison with the 7,5% withholding rate which can be credited in most of the DTTs.
[345] See Okeke 1997

establishing the NCCG Nigeria did not have a unified code of corporate governance.[346] Though it is still early to say as Nigerian corporations are transitioning to the new code but a well codified governance structure could make a real impact through the increase in trust in the Nigerian corporate world.[347]

From the point of a Finnish VC firm, the code's chapters on the relationship with shareholders, the board and assurance are especially important. The code outlines the need for equitable treatment of shareholders, transparency of ownership[348] and adequate protection of minority shareholders from abusive actions to govern the relationship of shareholders.[349] The GII puts Nigeria at 27th globally in minority shareholder protection[350] which is good news for VC firms although most VC firms take a more active position than exercising their rights at a general meeting as a minority shareholder. Most term sheets stipulate a board seat for the VC firm, so the dynamics of the board are important. A board in Nigeria is recommended to have a majority of Non-Executive Directors and that the majority of these directors to be independent[351] adding confidence through the objectivity of the board.[352] These independent non-executive directors are a typical mechanism in emerging markets to combat corruption.[353]

The last line of defence for a Finnish VC firm are the procedures of assurance. A company should have a risk management framework that defines risk policy, appetite and limits and then monitors the day-to-day business practices in line with the set boundaries. This framework goes through an internal audit at least quarterly and an external audit gives assurance to the entirety of the operation. For cases when rules are broken an anonymous whistleblower system needs to be in place for internal and external stakeholders.[354]

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[346] Some industries had their own code of governance but for many industries the NCCG will be the first contact with a code on corporate governance.
[347] George Etomi & Partners 2019
[348] Knowing the ultimate beneficiary owner of any stake above 5%.
[349] Part C Principle 23 of the Nigerian Code of Corporate Governance 2018
[350] WIPO 2020 "Nigeria"
[351] Below 0,01% equity in the company, does not have a business or personal relation with the company or its key members among other criteria. The list is much stricter than in most European jurisdiction showcasing the push for trust from investors.
[352] Principle 2 of the Nigerian Code of Corporate Governance 2018
[353] Wong and Barton 2006
[354] Principle 17 of the Nigerian Code of Corporate Governance 2018

The Copyright Act governs IP related issues and it empowers the Nigerian Copyright Commission to enforce and deal with infringement.[355] Although copyright is automatic the Commission advises Nigerian creators to register their works to enable better assistance from the Commission.[356] The commission and the Nigerian government have made an effort in recent years to crack down on IP infringements but protection is still very weak.[357] The International Property Rights Index of 2020 ranks Nigeria 123rd globally and 26th in Africa in IP protection.[358] One of the main challenges in IP protection for Nigeria is the strength of deterrents. The Copyright Act sets out the punishments for infringements at 10,000 Naira[359] for individuals and 50,000 Naira[360] for corporations.[361] The punishments have not been adjusted for inflation since 2004 making them toothless leaving seizure of goods as the only valid method of sanction. The situation with IP protection confirms an earlier point made about start-ups needing a product or service that does not require IP protection to be successful in the Nigerian market.[362]

In Nigeria, the arena of bankruptcy and creditors is heavily populated by informal processes and misuse of power.[363] Debts are a civil matter but public bodies overstepping their boundaries are not uncommon as in *Economic and Financial Crime Commission vs Diamond Bank* where debtors were imprisoned unlawfully to gain repayment of a debt. This creates a two-way issue for VC firms investing in Nigerian start-ups; if the start-up is owed money informal processes might be the only way to retrieve capital since the official legal means are weak[364] and if they owe money and are unable to pay the start-up can face unexpected actions from creditors.

Just by looking at the legal landscape Nigeria does not look like an optimal target market but it is important to remember that most start-ups are tech-based and run lean operations that can be easily extracted into other jurisdictions and are generally able to avoid many of

355 Section 30 Copyright Act, Cap C28, Laws of the Federal Republic of Nigeria 2004
356 Nigerian Copyright Commission 2021 ”About”
357 Edosomwan 2019
358 Property Rights Alliance 2020 ”Nigeria”
359 20,39€ on the 6th of March 2021
360 101,96€ on the 6th of March 2021
361 Section 27 Copyright Act, Cap C28, Laws of the Federal Republic of Nigeria 2004
362 Ollor and Dagogo 2009
363 Udo 2018
364 Idiaru 2020

the shortcomings of the legal system as the next chapter on the flourishing start-up scene will demonstrate.

4.1.3 Start-up Scene

The Nigerian start-up scene is driven by entrepreneurs filling gaps that the government or large corporation have neglected. Nigeria's ecosystem has an active network of support and its sheer market size enables start-ups to have great revenue potential just in its domestic market.[365] Strictly by investment Nigeria is the largest start-up market in Africa attracting $747million in VC in 2019 representing a 144% YoY growth. The number of deals also increased by 46% YoY.[366]

As the chapter on the current level of investment pointed out, Nigeria is very strong in fintech. Fintech is one of the industries where entrepreneurs are filling gaps left by institutions that have not been meeting the needs of society. In 2019 50,5% of African tech start-up funding went to Nigeria and 62% of this funding went towards Fintech which means almost a third of African tech VC goes to Nigerian fintech start-ups.[367] Edutech is another industry where start-ups are filling basic infrastructural gaps[368] left by the government. Private schooling is not seen as a prerogative of the well-off. Entrepreneurs are creating cost-effective tech-based solutions for private schooling.[369] The start-up uLesson[370] is an embodiment of this: it offers remote education via an app, browser or SD card at an affordable price[371]. The start-up raised €6.32mil in Series A in January of 2021[372]. The investment came from a Silicon Valley based global leader in edutech VC Owl Ventures[373].

Though Nigeria has tech centres across the country Lagos has become the epicentre of the start-up ecosystem.[374] Its population of 14 million makes it the 17th largest city in the world[375] so it is the natural home for what is referred to as Yabacon Valley which has been

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365 Ollor and Dagogo 2009
366 Partech Partners 2020
367 Partech Partners 2020
368 Education in Nigeria is below 10% of the annual budget. UNESCO recommends a 26% allocation for developing countries.
369 Kazeem 2020 (Quartz Africa)
370 uLesson.com
371 About €4 a month. This is 1,4% of the average monthly living wage in Nigeria of €282.
372 Crunchbase ”uLesson”
373 OwlVC.com
374 Ye! Community 2021
375 United Nations 2018

the epicentre for the Nigeria's start-up world since its inception.[376] Yabacon Valley boasts fast internet speeds and a cluster of hubs and incubators like the NG_Hub by Facebook[377] supporting the countless start-ups headquartered in the area.[378]

Nigeria ranks 72nd globally in the Venture Capital and Private Equity Country Attractiveness Ranking of 2018. The ranking highlights the strengths of having a large internal market and favourable labour regulations. On top of the challenges related to the legal and infrastructural situation in Nigeria already mentioned in the thesis, an additional challenge is seen as a major blocker, the currency.[379] The Naira has always been experiencing serious inflation[380] adding costs for the firms and heightening the risk relating to the investment. Investments made in Nigeria need to beat the inflation and then generate a return on top of that for foreign VC firms since the VC firm needs to pay its own investors in its local currency.[381] Foreign VC firms often invest in Dollars but that still does not protect[382] from the revenue fluctuations.[383] So a start-up with a booming domestic business is less attractive even with Nigeria's large internal market since its revenue will come in local currency which might devalue tens of percentage points a year in comparison to the Euro or Dollar.

The future challenges for the Nigerian start-up space are, as the chapter points out, infrastructural. Through better education, consistent and fair enforcement of the law, decreased corruption and stable fiscal policy Nigeria has a lot of room to grow. When the current challenges are mirrored with the current success of the start-ups it shows great resilience and ingenuity in the market;[384] VC firms and start-ups are not just accepting the current situation but are on the front lines pushing for change bolstering Nigeria's development.[385]

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376 Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
377 https://nghub.fb.com/
378 See Oyedemi 2019
379 IESE Business School and EMLYON Business School 2018
380 Central Bank of Nigeria 2021
381 Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
382 Hedges against the Nigerian Naira are an additional cost, complex and outside the purview of VC funds.
383 See Miles and Schreyer 2009
384 See Darambola 2012
385 See Phillips 2019

4.2 South Africa

4.2.1 Overview

South Africa has a turbulent past plagued with colonial rule and internal conflict. The country gained its independence in 1934, after hundreds of years of first Dutch and then British rule. As with Nigeria, independence started a dark time in the country's history of internal conflict.[386] The years of apartheid created wounds through society that are healing to this day.[387] In the years following the end of apartheid South Africa has managed to rebuild itself as the "Port to Africa". International businesses wanting to enter the African market often choose South Africa as an entry point into the continent's market.[388] Uber expanding to South Africa and achieving its fastest growth globally is a great example of South Africa's potential for African expansion.[389]

The reasons South Africa is the country of choice when entering the African market, despite its GDP of €237bn[390] being smaller than Nigeria's and Egypt's, are the diversity and sophistication of its economy and the solid formal infrastructure backed by a sound legal system.[391] Out of South Africa's 59 million[392] inhabitants[393], 72,3% are employed in services, 22,7% in industry and 5% in agriculture. The largest sub-industries are finance, real estate, business services and general government. As the sub-industries indicate, South Africa has a flourishing financial market as demonstrated by its 133-year-old stock market with a total market capitalization of €1090bn.[394] South Africa is one of the global leading producers and exporters of a number of natural resources[395] with platinum in its various forms making up to 9,3% of its exports. [396] The African average employment by agriculture is 60% and 23% of GDP value creation.[397] South Africa's 5% employment and 1,9% of GDP value creation[398] showcase how South Africa's economy has matured and diversified past its peers.

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[386] Thompson 2014
[387] See Vusi 2015
[388] Economic Diplomacy Programme 2012
[389] 800 Ventures "Why Africa"
[390] Statista 2021 "African countries with the highest Gross Domestic Product (GDP) in 2020"
[391] Economic Diplomacy Programme 2012
[392] Statista 2021 "African countries with the largest population as of 2021"
[393] 6th largest country on the continent by population. Only half a million less than 5th place Tanzania.
[394] Johannesburg Stock Exchange 2021
[395] Gold, platinum, chrome, manganese, palladium, diamonds, coal.
[396] Societe Generale 2021 "South Africa: The Market"
[397] McKinsey 2019 "Winning in Africa's agricultural market"
[398] Societe Generale 2021" South Africa: The Market"

South Africa's macroeconomic trends are worrying. The country's debt-to-GDP ratio is rising but even more worrying is the fact that the ratio is rising because of the fall in GDP and not heavy borrowing which could be an indication of large infrastructural investments. The GDP per capita experienced a steep drop[399] from 2011 to 2016 with some recovery towards 2018 but 2019 was again lower.[400] A few of the keys to South Africa returning to a path of growth: going up the value chain in mining, currently the country exports most of its resources raw, and reaching higher levels of tech adoption.[401] The country boasts a great infrastructure on which to build on; through the right governmental policy anything is possible.

4.2.2 Legal Landscape for VC Investments

The similarities with Nigeria continue in the legal realm. South Africa has a mixed legal system with primarily British common law influence. The South African legal system is built on Roman-Dutch civil law, British common law and African tribal customary law.[402] The country's highest court is the Constitutional Court which guards the constitution and protects everyone's human rights. The structure below the Constitutional Court is hierarchical with the Supreme Court of Appeal being the highest court that decides non-constitutional matters. South Africa also has a number of specialized courts to deal with labour, special income taxation, divorce and land claims among many others.[403] As mentioned in the overview, South Africa's legal system is one of its attractions for foreign investors and businesses when choosing targets for expansion and the GII ratings confirm this. The GII ranks South Africa's regulatory environment at 43rd and its rule of law 67th globally.[404]

Legislation in South Africa is embodied in acts.[405] The following acts will be touched on in this chapter because of their importance for VC investments in South Africa: the Companies Act, the King IV Report on Corporate Governance for South Africa, the Income Tax Act, the Financial Advisory and Intermediary Services Act, the Trade Marks Act, the Copyright

399 From 8000$ to 5300$ which is a decline of 34%.
400 Deloitte 2021 "South Africa: Risks remain, but South Africa catches a breather"
401 African Development Bank 2018 "South Africa Economic Outlook"
402 William 2000
403 The Department of Justice and Constitutional Development of South Africa 2021 "Courts"
404 WIPO 2020 "South Africa"
405 The Department of Justice and Constitutional Development of South Africa 1996

Act, the Patents Act, the Designs Act, the South African Insolvency Act and the National Credit Act.

Corporate Governance in South Africa very similar to that of other large economies. South Africa is part of G20 and has applied many of the best practices and has modelled its company law on that of Canada, Australia and New Zeeland.[406] In South Africa VC investments are typically done using a company structure, not a limited partnership.[407] When a company wants to start making VC investments in South Africa it needs authorisation from the Financial Advisory.[408]

Corporate Governance in South Africa has recently gone through a revamp. Companies have replaced the "Apply or Explain" of 75 principles with a simpler "Apply and Explain" 17 principle Governance structure. The code is voluntary and companies are given legroom in the way they apply these 17 principles but following the code is seen as the basis of sound governance.[409] The principles are built to help the firm achieve: an ethical culture, good performance, effective control and legitimacy. The philosophy of the governance structure is based on the idea of integrated thinking.[410] Integrated thinking is a relatively new way of approaching corporate governance in which all the different value streams that the business interacts with are taken into consideration.[411] This showcases how up to date South African corporate governance is and that it should not be seen as a hindrance to investments.

The GII highlights the ease of protecting minority shareholders, ranking it 13th globally as one of the strengths of South African innovation supporting infrastructure.[412] Most of the protection comes from the Company Act. It sets pre-emptions rights for current owners (also protecting against dilution)[413], establishes a takeover panel to ensure fair transactions[414] and empowers minority shareholders to apply to the court for protection against harmful actions by the majority.

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406 ECGI Global 2020
407 Westwood et al. 2020
408 Section 8 of the Financial Advisory and Intermediary Services Act 2002
409 The Foreword of the King IV Report on Corporate Governance for South Africa 2016
410 Fundamental Concepts the King IV Report on Corporate Governance for South Africa 2016
411 Oliver et al. 2016
412 WIPO 2020 "South Africa"
413 Section 39 of the Companies Act 71 of 2008
414 Section 196 of the Companies Act 71 of 2008

Like Nigeria, South Africa also has created tax incentives for VC investing. The investor is allowed to deduct the full amount invested from taxable income that year as long as the investment does not fall into any of the prohibited categories[415].[416] The corporate tax rate in South Africa is 28% and dividends are taxed at 20%. Unlike Nigeria, South Africa has an extensive[417] DTT network. The tax treaty with Finland stipulates a withholding rate of 0% for royalties and interest and a 5% or 15% withholding rate on dividends depending on the amount of equity[418] the receiver of dividends holds.[419]

Intellectual property protection is governed by a number of acts[420] divided by the target of protection and signed international conventions and treaties[421]. South Africa ranks 45th globally and 3rd in Africa in IP protection.[422] The protection has become stronger as South Africa has come under pressure from corporations to make its regulations stricter.[423]

In South Africa, the system of debt recovery and bankruptcy is built on the principle of favouring creditors. The South African Insolvency Act and the National Credit Act govern the space.[424] Relief for bankruptcy in South Africa comes in three forms: winding up, reorganization and judicial management. Winding up is the most common method and it can be triggered by debtors or the company itself. Reorganization is rare, it is mostly used to sell the company and often requires all or most of the debt being with one actor. Judicial management is most often brought in cases of mismanagement, it is similar to a US chapter 11 bankruptcy.[425]

[415] R50mil gross asset value of target company, over 20% of revenues come from investments, majority of its trade is outside of South Africa, trade in immovable property (unless hotel, student residence, service apartments) or trade in one of the following industries: financial service sector (unless fintech), financial or advisory services including legal services, management consulting services, and auditing or accounting services, gambling, liquor, tobacco, arms, or ammunition.
[416] Section 12j of the Income Tax Act 1994 but it is important to note that when it comes time to sell the equity stake the base value of it is considered to be 0 because of the initial tax deduction.
[417] 79 treaties
[418] If the recipient of the dividend owns over 10% of the equity they get taxed at a lower rate of 5%. Otherwise, the recipient gets taxed at 15%.
[419] PwC 2020 ”South Africa: Corporate - Taxes on corporate income”
[420] The most relevant for VC firms being: the Trade Marks Act, the Copyright Act, the Patents Act, the Designs Act, The Counterfeit Goods Act.
[421] The most relevant for VC firms being: TRIPS, Berne convention, Paris convention, Patent Cooperation Treaty
[422] Property Rights Alliance 2020 ”South Africa”
[423] Anderson 2006
[424] See Chitimira and Thabang 2019
[425] Gitlin and DeSieno 1997

The legal landscape is part of the attraction for foreign investors and corporations to come to South Africa. The facts stated in this chapter fortified this initial impression that South Africa has a good legal foundation for VC investment[426].[427]

4.2.3 Start-up Scene

The South African VC landscape mirrors the larger economy. It is heterogeneous with no industry having an over 14,2% share of total value or number of deals. Surprisingly, the largest industry by the value of deals in South Africa is food & beverage, followed closely by agriculture. By the number of deals the largest industries where business products & services and fintech, number one and two respectively.[428] Although food & beverage and agriculture are higher capital expense industries when their popularity in investment is mirrored with Finland, Europe or the US food & beverage or agriculture[429] does not even make it into the top five. It could be deduced that in the way Finland has a speciality in games and Nigeria has fintech South Africa has a comparative advantage in food & beverage. An example of a food & beverage start-up is the health soda company PURA[430] which received an undisclosed Series A from Knife Capital[431], a South African VC firm. The capital raised has helped the soda start-up reach 13 countries with one of them being the US.[432]

The South African VC and start-up space has experienced a major shift and expansion in the last ten years. In 2013 81% of entrepreneurs expressed that lack of funding in the early stages was their biggest blocker to success.[433] As the space has matured, this has been ratified with 53,8% of active deals in 2019 are early or seed stage. A lot of the new funds in South Africa are CVC, like seen in the US, and also from governmental programmes.[434]

In 2019 South African start-ups attracted €172mil in investments making it the country with fourth most invested capital on the continent. In the number of rounds South Africa was

[426] The research for this chapter was considerably easier than for the one on Nigeria. Laws are codified clearly and there is generally more information, a lot of it encouraging, on the legal landscape of South Africa.
[427] See Lemma 2015
[428] SAVCA 2020 ”Venture Capital Industry Survey”
[429] The reason why agriculture is not in the top 5 of Finland, Europe or the US is more obvious since it is such a large part of the African economy and minimal in more developed economies.
[430] https://livealittlepura.com/
[431] https://knifecap.com/
[432] Crunchbase ”Pura Soda”
[433] See Jones and Mlambo 2013 & Portmann and Mlambo 2013
[434] SAVCA 2020 ”Venture Capital Industry Survey”

number one accounting for 26% of deals made in Africa. Back in 2017, South Africa was number one also in funding but its small decline in investments combined with Nigeria's and Kenya's explosive growth has dethroned it as the start-up capital of Africa.[435]

South Africa ranks 36th globally in the Venture Capital and Private Equity Country Attractiveness Ranking of 2018. South Africa ranked highest out of all African countries because of its structural similarities in law with the UK, its strong financial market infrastructure and sound corporate governance practices.[436] Johannesburg with its 5,8mil inhabitants accounted for 44,3% of deals in South Africa. The 4,6mil inhabitant port city of Cape Town is another major start-up hub.[437] Cape Town is seen more as the tech hub and Johannesburg, as the capital, is seen as the centre for big business. VC firms are stationed in Johannesburg but the target start-ups, founders and developers being in Cape Town.[438] Cape Town currently has 450 to 550 active start-ups employing 40,000 people and a strong support network of incubators and hubs.[439]

All the chapters diving deeper into South Africa have uncovered a sturdy base on top which start-ups and VCs alike can build upon. Although the larger trends in South African are disconcerting with deal value dropping and the larger economy being in a downward trend too; South Africa's time as the port to Africa might be coming to an end.

4.3 Kenya

4.3.1 Overview

Similarly to both Nigeria and South Africa, Kenya was under British rule. Kenya negotiated its independence last out of the three in 1963.[440] The post-independence era was dominated by a political party of single tribe until 2002. The assets held by the British were not returned to their original owners but kept with the ruling party sparking internal conflicts that escalated into tribal violence.[441] Though there are still major tribal divisions, in the years following the fall of the one-party-rule, Kenya has turned the tides and undergone a number of

[435] Partech Partners 2020
[436] IESE Business School and EMLYON Business School 2018 and Ecosystem
[437] SAVCA 2020 "Venture Capital Industry Survey"
[438] See Jackson 2018 (Disrupt Africa)
[439] Invest Cape Town 2019
[440] Ochieng 1985
[441] Mutua 2008

political, structural and economic reforms which have turned it into one of the fastest-growing economies in Sub-Saharan Africa.[442]

Kenya has what is considered more of a traditional African economy in comparison with Nigeria and South Africa.[443] Its total GDP of €85bn makes it the sixth-largest economy on the continent.[444] Kenya's population[445] of 54mil[446] is relatively evenly spread across agriculture and services with industry being a low 16,1% of GDP and 6% of the workforce. Agriculture is 34,1% of Kenyan GDP and it employs 53,8% of the workforce. Kenya is the third-largest producer and the largest exporter in volume of tea. Tea accounts for 19,1% of its exports. Other major commodities Kenya exports are flowers, coffee, fruits and potentially in the future oil and gas with a potential for 750mil barrels[447]. The service sector is 43,2% of GDP and employs 38,7% of the workforce with tourism, IT and communications being the major sub-industries. Kenya's general economic sophistication and readiness to support innovation is what makes it a regional hub for business. Kenya was the first country that sold governmental bonds through mobile phones[448] and the domestic stock exchange with a €19bn market cap has been a driver in developing and establishing mobile trading for the rest of Africa.[449]

Kenya seems to have the most positive future outlook out of the three countries covered. Its GDP growth of 5,7% in 2019 was one of the largest in Sub-Saharan Africa.[450] The future growth looks even brighter, in 2021 Kenya is expected to become the fastest-growing economy in Africa with a 6,9% GDP increase.[451] The growth is a result of the "the Big 4" plan which focuses the efforts of the country on four key pillars for the next five years: enhancing manufacturing, food security and nutrition, universal healthcare coverage and affordable

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[442] World Bank 2020 "The World Bank In Kenya"
[443] See Dercon and Gollin 2014
[444] Statista 2021 "African countries with the highest Gross Domestic Product (GDP) in 2020"
[445] 7th largest in Africa.
[446] Statista 2021 "African countries with the largest population as of 2021"
[447] To put it in context Romania, Italy and Denmark have 600mil barrels and Nigeria's reserves are 50x of what Kenya potentially has in reserves so it is a relatively small amount that will not majorly impact Kenya's economic prospects.
[448] Societe Generale 2021 "Kenya: The Market"
[449] Nairobi Security Exchange 2021
[450] World Bank 2020 "The World Bank In Kenya"
[451] World Bank 2021 "Global Economic Prospects"

housing.[452] If the set-out plan reaches its goals[453] Kenya will become a major powerhouse on the continent and work its way towards the governmental vision dubbed "Kenya 2030" to become "a globally competitive and prosperous country with a high quality of life by 2030".[454] Getting in early and gaining experience and share in the market might become very valuable in the future if the momentum keeps up.

4.3.2 Legal Landscape for VC Investments

Kenya also falls into the basket of a mixed legal system. The ideological pillars of Kenyan law are English common law, Sharia law and Tribal law.[455] Reaching the current point in Kenya's legal landscape has not been a smooth journey[456] with the country's constitution amended over 30 times since independence.[457] The most recent amendment in 2010 has finally addressed the core issue of governmental power being abused[458] although it did not enhance governmental accountability.[459] The recent amendments have been major drivers in Kenya's rapid development.[460]

Kenya's Supreme Court has the final ruling power in Kenya's judicial branch. Below it in hierarchy exercising the doctrine of precedent follow the Court of Appeal, the High Court, the Magistrate's Courts as well as specialized courts and tribunals.[461] Kenya is ranked by GII 88th globally in rule of law and 89th in regulatory quality[462] placing it somewhere in between South Africa's sound legal structures and Nigeria's weak but developing system.

The regulation of the Kenyan VC space specifically is still in a nascent stage. It is policed by the Capital Markets Authority[463] which in an effort to develop the regulation has drafted

[452] Kenyatta 2021 "The Big Four"
[453] Within five years: 15% of GDP from manufacturing sector, 500,000 affordable houses to Kenyan families, 100% universal health care coverage, 100% food and nutrition security.
[454] Kenya Vision 2030
[455] Daniels et al. 2011
[456] Joireman 2006
[457] Federal Research Division 2007
[458] The constitutional power given to the government are remnants from the colonisation when the British elected local leaders who ruled like dictators over their areas and from the almost 40-year one-party-rule which needed constitutional backing to stay in power.
[459] Akech 2011
[460] See Khaunya et al. 2015
[461] Kenya Law 2021 "What is Law Reporting?"
[462] WIPO 2020 "Kenya"
[463] Government agency that was established in 1989

a new comprehensive legal framework with various VC stakeholders to support the development of Kenya's VC and thus the start-up market. This new legislation is currently going through the process of being enacted.[464] The current framework for VC firms in Kenya is governed mostly by the following acts: the Capital Markets Act, the Finance Act, the Tax Laws (Amendment) Act, the Income Tax Act, the Companies Act, the Industrial Property Act, the Export Processing Zones Act and the Insolvency Act.

The Capital Markets Act is the major regulator of VC in Kenya. The Capital Markets Act was recently amended by the Finance Act. Now any VC firm operating in Kenya needs to be licensed and approved by the Capital Markets Authority if they have access to public funds[465].[466] In cases of no public funds, the Capital Market Authority has an optional registration process for the firm to become a registered venture capital company[467] which has unsurprisingly led to a situation where there are zero[468] registered venture capital companies in Kenya.[469] The registered VC firms would follow the Capital Markets (Registered Venture Capital Companies) Regulations which also set out the process and requirements of registration.[470]

Though Kenya does not have a standardized code for corporate governance for non-public companies' minority investors can be confident in their protection against majority abuse. The GII ranks Kenya's ease of protecting minority shareholders number one globally.[471] This incredible achievement was built through expanding and strengthening disclosure requirements, adding regulatory approval to transactions, increasing available remedies for when transactions are prejudicial, increasing shareholders' rights and role in major corporate decisions and greater corporate transparency.[472] As a concrete example, the renewed Companies Act enables any member of the company the *locus standi* to take the company to court

[464] Marone 2019
[465] A lot of Finnish VC firms have public investors in their funds so this is a step that firms would need to complete.
[466] Section 30 of the Finance Act No. 8 of 2020
[467] "A company approved by the Authority and incorporated for purposes of providing risk capital to small and medium-sized businesses in Kenya with high growth potential, whereby not less than seventy-five per cent of the funds so invested consist of equity or quasi-equity investment in eligible enterprises;" Section 2 of the Capital Markets Act Chapter 485A Revised Edition 2012
[468] CMA 2021
[469] Section 11 Subsection 3(f) of the Capital Markets Act Chapter 485A Revised Edition 2012
[470] Sections 3-7 of the Capital Markets (Registered Venture Capital Companies) Regulations 2007
[471] WIPO 2020 "Kenya"
[472] World Bank 2020 "Economy Profile: Kenya"

if oppressive conduct or unfair prejudice has transpired.[473] In blatant cases of criminal abuse and fraudulent activity, the Companies Act lays down steep[474] penalties.[475]

On the base level, Kenya's corporate tax is 30% for resident companies (also foreign subsidiaries count) and 37,5% for branches of foreign companies.[476] To stimulate investment Kenya has what is referred to as the Export Processing Zones Program. It is a perfect fit for a VC firm as an investing entity or part of a target start-up.[477] A firm that fits the criteria for the EPZ Program and receives a license enjoys 10 years of no corporate tax or withholding tax after which a 25% tax rate for the next ten years is after which levied the normal 30% rate becomes applicable.[478] There are also other benefits of joining the program like rapid project approvals, inexpensive facilities built for participants in the program and many others[479] to enable growth and new exports for Kenya. To be eligible for these benefits the firm needs to be incorporated in Kenya, undertake activities[480] that are eligible for EPZ, not have a "deleterious" impact on the environment and conduct business in accordance with the laws bar any exemptions given.[481] Looking at Kenya's DTT network it is closer to Nigeria than South Africa. It currently has 17 DTTs but does not have one in place with Finland and the sans a DTT withholding rate is 15%.[482]

Kenya ranks 86th globally and 10th in Africa in IP protection.[483] In the new 2010 constitution, IP has been prioritized and transformed by making it compliant with TRIPS. With its constitutional status, it is now the base of legal frameworks and policy affecting businesses. These significant changes are taking time to reverberate across the business world with one of the key challenges the Kenyan Industrial Property Institute[484] faces being the promotion

[473] Section 780 of the Companies Act No. 17 of 2015
[474] Fines of up to 8000€, disqualification from practice for up to 15 years and imprisonment up to 7 years.
[475] Section 818 of the Companies Act No. 17 of 2015
[476] Head B Section 1 of the Income Tax Act Chapter 470 Revised Edition 2012
[477] Export Processing Zones Authority Kenya 2021
[478] Eleventh Schedule Section 1 of the Income Tax Act Chapter 470 Revised Edition 2012
[479] 100% investment deduction on new investment, Perpetual exemption from payment of stamp duty on legal instruments, Perpetual exemption from VAT and customs import duty on inputs, Operation under essentially one license issued by EPZA, No Exchange Controls – liberalized foreign exchange regime, Onsite customs documentation and inspection by Customs Staff, Unrestricted investment by foreigners, One-Stop-Shop service for facilitation and aftercare.
[480] Focuses on horticulture/food processing, textile/apparel, leather, commercial crafts, BPO or ICT sector.
[481] Section 23 of the Export Processing Zones Act Revised Edition 2012
[482] PwC 2020 "Kenya: Corporate – Withholding taxes"
[483] Property Rights Alliance 2020 "Kenya"
[484] Established by Section 3 of the Industrial Property Act No. 3 of 2001 Revised Edition 2016

of greater public understanding of IP rights and their utilization.[485] But already at its current level, the share of IP receipts of total trade is ranked 25th globally by the GII.[486]

The Insolvency Act is the main legislation for bankruptcy and creditors in Kenya. It has taken a different approach from the Company Acts provisions which have previously steered the insolvency process. The Insolvency Act is built on the principle of trying to through administration restructure and give a new lease on life to the company instead of straight liquidation.[487] The case *St. Mark Freight Services Limited v Sarah Wangui & Another* show-cases the debt collection and enforcement by the courts when foreign companies are dealing in Kenya. The process is arduous and built on the for-commission debt recovery industry but still far from the informal processes mentioned in the chapter on Nigeria.

As mentioned a few times during this chapter the legal landscape's support for VC and business in general seems to fall in between Nigeria and South Africa with clear governmental efforts to drive change that have maybe not yet been reflected in the market to the levels that they were intended.

4.3.3 Start-up Scene

Referred to as the "Silicon Savannah" Kenya's tech start-up space has, similarly to the larger economy, experienced quite a transformation in the last decade.[488] Its militating factors outweighed the potential of the country for investors since its independence.[489] This started changing after 2010 with VC endeavours popping up in Kenya creating profitable exits, jobs and tax revenue.[490] Currently, Kenya has the second largest start-up market in Africa. It received start-up funding of €472mil and 52 deals were made with funding growing 62% YoY and the number of transactions 18%.[491] The main drivers in transforming the Kenyan start-up space were the availability of affordable ICT equipment and the development of the internet and telecommunication industry in the country[492].[493]

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485 WIPO Magazine 2016 "Strengthening Kenya's IP Landscape"
486 WIPO 2020 "Kenya"
487 Oraro & Company 2018
488 Hain and Jurowetzki 2018
489 Ikejiaku and Mordi 2010
490 See Memba et al. 2012
491 Partech Partners 2020
492 The development of the Kenyan start-up space is likened to India's path.
493 Startuplist Africa 2020

The start-up space is heavily focused on Nairobi.[494] With a population of 4,5mil, it is the home to a talented workforce large tech companies[495], incubators, co-working spaces and accelerators. Investors in Kenya seek “frugal innovation” to meet the markets’ needs; ideas that grow exponentially at a low marginal cost and leverage tech to do this.[496] The main industries for start-ups in Kenya are renewable energy, agritech and logistics.[497] M-Pesa laid the groundwork for these industries to thrive by enabling mobile payments.[498]

Twiga Foods is a great example of a start-up that plays into both the agritech and logistics industries and is built on the mobile payment infrastructure. It is a transparent and cashless marketplace platform and delivery service enabling farmers to sell their harvests to retailers without taking on the challenges of logistics and sales negotiations. Twiga Foods has raised €90mil to date and is currently taking on African expansion.[499] Another high-profile Kenyan start-up is M-Kopa. It offers mobile-based energy solutions to low-income customers enabling them to pay off solar solutions in instalments building a credit record enabling further financial health. M-Kopa has raised €156mil from all over the world and has enabled over 1mil people to access solar lighting and other energy-efficient products.[500]

Kenya ranks 53rd globally in the Venture Capital and Private Equity Country Attractiveness Ranking of 2018. Kenya is also the country that has the largest change in the attractiveness ranking from 2014 to 2018. Kenya improved its standing by 37 places which is a testament to something that has been repeated already many times during this chapter: the post-2010 Kenya is developing at a rapid pace.[501]

Something that concretizes the ambition of the Kenyan start-up space for the future is the €12,4bn governmental project of Konza Technopolis. When completed in 2030[502], it is going to be a 20 square km technology hub city, between Nairobi and the port town of Mombasa.[503] It is a project suitable in zeal to match the growth of the market.

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[494] See Rosenberg and Brent 2020
[495] Intel, Microsoft, IBM and Google.
[496] Startup Guides 2020
[497] Hain and Jurowetzki 2018
[498] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
[499] Crunchbase 2020 ”Twiga Foods”
[500] Crunchbase 2020 ”M-Kopa”
[501] IESE Business School and EMLYON Business School 2018
[502]One of the key drivers of the Kenya 2030 vision.
[503] Konza 2021 ”Vision and Mission”

5 Obstacles

5.1 Methodology

There are two types of obstacles for Finnish VC firms to invest in Africa: firstly, the obstacles that are perceived by the people making investment decisions and secondly, the actual obstacles that would stop an investment process. The difference between these two groups is determined by the time spent researching the subject matter. The more informed, the less assumption based the obstacles become. As the assumption-based obstacles hold within themselves the research-based obstacles the best way to gather the information is a qualitative interview but as part of the interview trying to determine has research gone into these assumptions.

The main goal was to interview every single active Finnish VC firm. The answer base was already small, so every interview was valuable. Out of the 35 firms classified as VC firms in the FVCA member list 26 fit the criteria of being still active and being Finnish[504]. To achieve the goal of getting an answer from every single firm a few aspects in interview quality had to be compromised on. These compromises might affect the results but they were a trade-off for getting maximum data on the market: the method of interviewing, the language used and the differences in the firms. All the answerers were assured of anonymity to get the most honest answers and to not be wary when talking about the strategy the particular firm deploys when seeking out investment targets[505].

The method of answer collection was two-tiered. The first attempt to get answers was by phone. If that failed, a request for a call followed by a text message or email. If the request for an interview was not answered the questions were emailed which led to an answer in all cases[506]. The people chosen as targets for the interviews held senior positions[507] in the firms so that the answers would come from a point of authority and experience. 69% of the interviews were conducted over the phone. The remaining 31% over email because of the failure

[504] Non-Finnish VC firms are members of the Association.
[505] A concern that was raised a few times during the calls before I was able to mention the anonymity of the interview.
[506] After attempting a few different people within the organization.
[507] For example: managing partner, partner, CEO, senior analyst, dealflow manager, investment director.

to get someone from the firm on a phone. As it was expected that some of the interviews would be conducted via email this was reflected in the creation of the questions. The questions were made simple and very straight forward to maximize the cross-platform answer comparability. This led to no major difference in the quality of answers from the point of the thesis.

Another factor that might have affected the answers was that the interviews were conducted in two different languages. Some interviews were in Finnish and some in English and at the point of translation an answer could be interpreted wrongly. Although the writer of the thesis had at the point of interviews been immersed in the thesis already for months so the basic parlance of the VC world in both languages was at a level that was good enough to make the choice to accommodate the language preferences of the interviewee.

Finally, the heterogeneity of VC firms in Finland affected the answers given. There are two metrics that differentiate VC firms in Finland. The first one is the stage at which they invest. The earlier the VC firms invest the less capital it deploys and the more involved they are generally. This in turn might affect what is seen as an obstacle when venturing to Africa.[508] The second metric is industry focus. Being a generalist or a specialized fund brings with it its own challenges. As earlier mentioned, a specialized fund might be more ready to venture out of the Nordics because of the niche space they are inhabiting in comparison with a generalist that is able to get enough deal flow in a considerably smaller market. In an ideal situation the answers could be divided by type of VC firm but with just 26 potential interview targets further subcategorizing them would diminish the value of the interview data.

As preparation for the interviews data was gathered from all the firms' websites to have a base understanding of the firm during the interview to better understand the answers to the questions that would be asked. Also, the base research provided a further overview of the Finnish VC space. The specialization, size and geographic focus of the firms were gathered before the interviews. The data gathered helped formulate the questions to figure out what was needed for the thesis that was not publicly available and it also helped in building a rapport with the interviewee.

[508] FVCA 2020 ”H1/2020 Finnish Private Equity Activity: Venture Capital”

To assure a high response rate and easy comparability through thematic analysis three questions were chosen for the interview. Having just three questions enabled the possibility to get answers within one to two minutes during a call and gather the bare-bones data if the interviewee was tight on time but the open-endedness enabled also a longer discussion. This seemed to work as the calls ranged from 90 seconds to 15-minute discussions depending on the firm. The first question asked was "Why do you have a geographic focus on investments?"[509]. The second question asked was "Have you ever thought of investing in Africa?"[510]. And the third question was "Why did you answer Yes/No to the previous question?"[511].

The first question was to confirm the data gathered from the initial research on the firms' websites and to give reasons why there is a geographic focus in the first place. The answers to the questions did not just provide data for gathering the obstacles but also gave insight into the different VC strategies and ways of attacking the market.

The second question was instructed to be answered in a simple binary yes or no to have a clear percentage of how many firms have even though of Africa as an investment. This question was also the earlier mentioned way of measuring the level of assumptions in the answers. Though a binary answer provides a clear quantifiable data point the weakness is that there might be different definitions for "thinking of investing" but based on the longer discussions "thinking of investing" was considered a synonym for research in the area.

The third question is the meat and potatoes of the interview. It encourages the VCs to list reasons why they are not thinking of investing in Africa or why they are thinking of investing in Africa. As only one hybrid Finnish-African investment has been made, as mentioned earlier in the chapter on Finnish VC activity in Africa, all the answers were on why they are not investing in Africa. The point was to get concrete obstacles but also have answers to mirror with the first question.

The most important goal that was set out for the interviews was achieved. The thesis has a 100% response rate from the applicable 26 firms chosen for interviews. As the first and third

[509] In Finnish: "Miksi teillä on maantieteellinen rajaus sijoituksissa?"
[510] In Finnish: "Oletteko koskaan harkinneet Afrikkaan sijoittamista?"
[511] In Finnish: "Miksi vastasitte kyllä/ei edelliseen kysymykseen?"

questions were left open-ended the responses varied in length and depth. All the answers seemed to be in line with earlier research on the firms and gave very valuable insight into the inner workings of the firms. For the writer of the thesis, it was a pleasure to have all these conversations, however short, and the wide range of thoughts and points of view were very helpful with the end goal of the thesis in mind. The following chapter will break down the results gathered.

5.2 The Results

5.2.1 Question I

The first question was "Why do you have a geographic focus on investments?". The interviewees gave a total of 41 reasons.[512] The answers were grouped into 8 reasons to make the data clearer. A few examples of how thematic analysis was performed: "investors have decided into what geographies they want their money invested" was categorized as "mandate", "we feel we know our Nordic environment well" was categorized as "local expertise" or "our style of VC investing is a contact sport" into "being geographically close to founders". As the examples demonstrate, assumptions were made whilst grouping the reasons but they were kept at a reasonable level. Also, firm-specific information that would unveil the firm giving the answer was removed.

After the necessary grouping five main reasons emerged: mandate, being geographically close to founders, networks, local expertise and lack of resources. Logically, the number one reason for geographic focus was mandates. 40% of interviewees mentioned it as one of the reasons. A surprising[513] second was being geographically close to founders at 36% of interviewees mentioning it. The third most mentioned reason at 24% was networks. This means networks for the investment stage (sourcing) but also for the business development stage when looking for potential partners for example. The fourth place was divided at 20% of interviewees mentioning local expertise and lack of funds. Lack of funds referring to the additional costs associated with international sourcing and the higher premiums in more condensed markets like the US.

[512] See Appendix B Q1 for the breakdown of the reasons.
[513] When mirroring with all the literature read on VC during the process of writing the thesis.

5.2.2 Question II

The second question was a simple binary "Have you ever thought of investing in Africa?". Out of the 26 firms asked 6 answered affirmatively making the total percentage of firms that have thought of investing in Africa 23%. As mentioned earlier, this question was posed to have a sense of the level of assumptions made in expressing the blockers. 23% is a low number although as the thesis has pointed out the African VC market is in a nascent stage and the whole idea of the thesis is to examine how Finnish VC firms could join the first movers venturing to Africa. However, the 23% still weighs the obstacles more towards the assumption category.

5.2.3 Question III

The third question "Why did you answer Yes/No to the previous question?". As 77% answered "no" to the second question there was no shortage of potential obstacles. A total of 53 obstacles[514] were given by interviewees. In a similar manner to the first question, the obstacles were grouped into 11 reasons to maximize the usability of the answers. Four obstacles stood out of the answers: lack of local expertise, being geographically far from founders, corporate governance and lack of network. Understandably, the blocker of lack of local expertise was mentioned by 40% of VC firms. It was followed by being geographically far from founders at 32%. The third place was a tie between a lack of networks and corporate governance with both being given by the 24% of the interviewees.

5.2.4 The Obstacles for Analysis

Instead of just taking the four most mentioned obstacles in QIII, it is important to look at the dataset as a whole. QI determines the firms' possibilities and attitudes towards investing across borders, so the answers are impactful too. Not taking QI reasons into consideration would lead to just addressing the theoretical reasons why no companies are investing in Africa but ignore the concrete ones why firms have drawn a line up to where they are willing to invest. The importance of QI is also heightened because Africa seems to be outside most of these lines.

[514] See Appendix B Q3 for the breakdown of the obstacles.

When looking at the data from QI and QIII there is a certain amount of overlap and four reasons stood out to the extent that they are undoubtedly the ones that need to be addressed. The four obstacles that the thesis will analyse for a solution in the final chapter are: corporate governance & unknown risks, local expertise & networks, being geographically far from founders and mandates.

Corporate governance was combined with unknown risks for a few reasons. Corporate governance expresses the challenges firms might face actively invested in the start-up and dealing with the entrepreneur. Unknown risks, as aptly put in one interview, are “the fear of not knowing what we don’t know when investing in Africa”. These unknown risks work into corporate governance since it is the mechanism to minimize the uncertainty when dealing with a start-up. Combined corporate governance & unknown risk were mentioned by 40% of people in QIII and 8% in QI.

Local expertise and networks were also combined since they supplement each other. Having networks gives you knowledge and having knowledge of the local market means having networks. They are hard to come by themselves. This obstacle is numerically the most mentioned with a combined 44% in QI and 64% in QIII.

Being geographically far from founders is quite self-explanatory. A big part of VC investing is relationships[515] and managing those relationships face to face is something VC firms seem to prefer. Also geographically far might actually refer to culturally far[516] which will be touched on too in the analysis on this obstacle. It was mentioned by 36% in QI and 32% in QIII.

Mandates arose as a reason in QI by 40% of the interviewees and 20% in QIII. As mandates are the gatekeeper to the capital within the fund it is important to analyse them even though they were not one of the main obstacles arising in QIII. Looking at how and why they are negotiated and what are the typical provisions in them might give insight into why emerging markets seem to be left out in many cases.

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[515] Turcan 2008 and also based on interviews held for the thesis. Came up countless times, especially when discussing the blocker of being far from founders.

[516] Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021

6 Analysis and Potential Solutions to Obstacles

6.1 Methodology

After the interviews with Finnish VC firms, the four obstacles seen as the main blockers need to be countered with solutions. To propose solutions to these obstacles based on a review of academic output and local legislation (*de lege lata*) is not enough for a few reasons. The main reason being that the obstacles are quite abstract and complex. They do not point towards a clear solution like for example an obstacle: “Kenya’s taxation is not VC friendly” would. Another reason is the fact that the thesis is dealing with an emerging trend and the academic research output into the field has not yet caught up so the material based on which the analysis would be built is lacking. Another additional source of knowledge is needed to create actual valuable solutions and the obvious choice are people dealing with the African VC and start-up space. This led to the choice of conducting a round of interviews to obtain insight from these market participators on how to approach these four obstacles and what solutions they would deploy to overcome them.

To get an experienced point of view on the blockers eight interviews were conducted with four different points of view that are immersed into the African start-up scene: African VC and investment firms, International VC firms that invest in Africa, the African Venture Capital Association and FinnFund. Getting different points of view and ideas to overcome the obstacles is especially important since there is no Finnish VC firm currently investing in Africa that could offer a set process that would be proven to work.

The first point of view came from African firms that know the local market, culture and are able to offer solutions that are currently in use and see the obstacles from the point-of-view of the local start-up. The people interviewed were Khaled Jilani a Senior Partner at Africinvest[517], Tito Cookey-Gam a Senior Analyst at Echo VC[518], Eric Osiakwan a Managing Partner at Chanzo Capital[519] and Funmi Makinwa a Compliance Manager at CcHub Nigeria[520].

[517] A firm founded in 1994 with 18 funds and over €1,44bn raised.
[518] A Nigerian VC firm with companies operating in 12 countries across the world with €35mil deployed.
[519] A Ghanian VC firm investing in high-tech start-ups in Africa with €20mil deployed.
[520] A pre-incubation space and lab in ”Yabacon Valley” in Nigeria. It also has a fund of €2mil and has helped over 95 ventures.

All these interviews were very insightful and offered concrete solutions to the obstacles as well as giving cultural context.

Two interviews were conducted with representatives of international VC firms. Hans Osnabrugge a Partner at Brooklyn Ventures[521] and Dustyn Winder a Founder and Managing Partner at Akili Ventures[522] gave interesting insights on venturing into the African start-up market while not being a local and the solutions they have utilized to thrive on the continent.

Vasiliki Ntina a Research Associate at AVCA was able to give big picture information, how the space has changed over the years, where to focus additional research and what the current trends are and also confirming the basis for the thesis that Africa is experiencing a wave of investment.

The interview with FinnFund's Investment Manager Johanna Raehalme was central in understanding the blockers from the point-of-view of someone who invests in Africa from Finland since, as mentioned earlier, FinnFund is the closest entity to a Finnish VC firm investing in Africa. The interview with Johanna Raehalme was scheduled last so also some of the solutions brought forth by the other interviewees could be dissected from the point of a Finnish investor.

The interviews were conducted over Zoom by video call because of the pandemic and geographic distance of most of the interviewees. All of the interviews had a similar process with the interviewee first listening to a summary of the thesis and how the obstacles were gathered and chosen. This was followed by a free discussion on each of the four obstacles with the ask that they try to think of ways to counter them by disproving or giving solutions.

The following chapter will cover one by one the four chosen obstacles and the information gathered from the interviews will be used to steer and find applicable research for solutions and to back these solutions up.

[521] A Dutch-based VC firm with a lot of activity in Africa and an especially active investor attitude which was perfect for getting insights for the thesis.
[522] A VC based in Kenya with an international team investing in African ventures.

6.2 The Obstacles

6.2.1 Mandates

Every VC firm has a mandate for all of its funds. The mandate agreement sets the parameters for the investment activity of the fund. Typically, limitations are set for the geography, stage or sector of the start-ups the fund can target.[523] These limitations are a way for investors (limited partners) to align their objectives[524] with the VC firm's actions.[525] During the interviews with Finnish VC firms, mandates were mentioned in QI[526] by 40% of interviewees and by 20% in QIII[527]. At first glance, mandates are an obstacle that is hard to overcome since it is so set in stone and it is created not just by the VC firm but investors (limited partners) play a key role in setting a mandate too. The chain does not end there either; the limited partner typically[528] has its own investors bringing another mandate into the picture. This chain of actors makes the obstacle more complex than just changing a VC fund's mandate to include Africa.

As chapter 2.3.2 on the current state of Finnish VC pointed out Finland has gone through a major structural revamp with direct investments by public bodies subsiding and the private VC fund industry taking the lead. The public money has moved from the frontlines into funding the VC firms doing the investing.[529] Business Finland has invested in 13 Finnish VC funds. The share of private capital[530] in these funds is 51%[531].[532] Another source of public capital in some Finnish VC funds is the European Investment Fund.[533] The requirements tied to public investor capital were raised as a main driver in the mandate obstacle.[534]

523 Ford and Nelsen 2014
524 Risk tolerance and return expectations for example.
525 FCLT Global 2020
526 "Why do you have a geographic focus on investments?"
527 "Why did you answer Yes/No to the previous question?" (The previous question: "Have you ever thought of investing in Africa?")
528 Unless a private person is investing.
529 Ministry of Employment and the Economy 2014
530 As Business Finland states "Our investment is considerable in relation to the total size of a fund, however it does not exceed 50 per cent of total commitments."
531 €94mil out of €184mil
532 Business Finland 2021 "Venture Capital Investments"
533 EIB and EIF 2019 and the fact that EIF has invested came up during the interviews with Finnish VC firms.
534 Based on interviews with the Finnish VC firms discussing blockers.

Funds with capital from EIF are required to have 85%[535] of investments within the EU.[536] When it comes to capital raised from Business Finland, which seems to be prevalent in the Finnish VC space, a major change has occurred in geographic mandate requirements and it is good news from the point of the thesis. Up to 2019 if Business Finland invested in a fund the fund was allowed to invest a maximum of 15% of its raised capital abroad. In 2019 the number changed to 40% and most recently in December of 2020 to 50%. The change was made to encourage more specialized Finnish VC funds, which are as research has pointed out are more profitable[537]. Since Finland's internal market is not large enough to facilitate specialized firms that would invest 85% of their funds in Finland the geographic requirement had to be loosened.[538] This means that funds set up from December 2020 onwards will be much more geographically mobile and incentivised to research deal flow outside Finland or the Nordics.

When discussing the mandate obstacle with the interviewees with experience in the African market they found it understandable because of the risks tied to the continent[539] and had come across the same challenges when seeking more global VC partners for their portfolio companies expanding outside the domestic market.[540] Although, the interviewees have noticed positive development in mandates in the VC world recently, like the example with Business Finland, to accommodate more geographically diverse investing.[541] African start-ups have also adapted to the mandate challenge and many of them seeking more international funding incorporate in the US or Europe to be reachable within the parameters set in geographically fixed mandates.[542]

When looking at the obstacle again with the new information on how Business Finland is now approaching mandates and how African firms are incorporating in Europe and the US the only challenge left is demystifying Africa as an investment target so that it becomes

[535] Does not specify if by amount or value.
[536] EIB and EIF 2019
[537] Gompers et al. 2009
[538] Interview with Petri Serenius the Investment Director at Business Finland Venture Capital on the 29th of March 2021
[539] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
[540] Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021
[541] Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021, Khaled Jilani from Africinvest on the 12th of March 2021 and Vasiliki Ntina from AVCA on the 16th of March 2021.
[542] Interview with Khaled Jilani from Africinvest on the 12th of March 2021

considered as part of investment strategies. For Finnish VC firms, FinnFund is leading the way in this regard.[543]

6.2.2 Being Geographically Far from Founders

The term that kept popping up in interviews was "contact sport" when discussing VC referring to the fact that VC fund managers want to be in the proximity of the founders they are investing in. In QI 36% of interviewees mentioned being close to founders as a reason for having a geographic focus and 32% in QIII mentioned being geographically far from founders as an obstacle to invest in Africa. Research seems to back this up partly: being part of an ecosystem and investing in it brings superior returns. However, these superior returns are not tied to the home of the VC firm and they can be replicated anywhere where similar activities are taken on. After the first investment in a new geographic area, the marginal monitoring costs of the market drop, and the success rate goes up.[544]

On a most basic level, when there is a geographic difference there are two ways to close it: trips or having someone on the ground. Taking trips is a solution that FinnFund employs. Before an investment, FinnFund takes a week to travel out and meet the founding team and appraise the business.[545] Opening an office in the target geography is another option to get a geographic footprint but hard to financially justify for a single fund unless the amount invested in Africa would be a substantial portion of the portfolio.[546] A hybrid solution would be to create an accelerator program[547] though again, as with someone on the ground, the costs associated for a single firm are exorbitant thus requiring a unified effort from multiple backers.[548]

The Covid-pandemic has demonstrated how VC activities can be accomplished virtually without physically meeting founders. All of the interviewed investors in the African market said they have managed to do deals during the pandemic without meeting the founders but

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[543] Interview with Funmi Makinwa from CcHub Nigeria on the 26th of March 2021
[544] Chen et al. 2010
[545] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021 and Tito Cookey-Gam from Echo VC on the 18th of March 2021
[546] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021 and Hans Osnabrugge from Brooklyn Ventures on the 11th of March 2021
[547] As an example, a six-week accelerator program in Africa once a year to find one to three investments. Accelerators are often government-subsidized because of the high cost which is another obstacle since it would require the persuasion of a government entity in the target country or in Finland to fund a part of the program.
[548] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021

stressed the point that not being able to meet them has put emphasis on networks and local knowledge, the next obstacle that the thesis will cover. Having a good knowledge base and networks in the markets circumvents the need for meeting face-to-face.[549] This is also supported by the fact that most US VC funds with investments in Africa have never set foot on the continent.[550] Although, from a Finnish point of view this applied only to later stage companies. Early stage companies need so much "hand-holding" that not even the abovementioned trips to the continent are enough. Series B companies onward were described as self-sufficient enough to invest in without much contact.[551] As VC backed start-ups are expected to scale quickly the later stage start-ups are ideally global in their actions and mindset in the same sense a Finnish or Nordic start-up would be so the challenges faced are similar; targeting the biggest markets and looking for rapid growth.[552] This is also evident from the interview data with Finnish VC firms; the earlier the stage focus was the more often being far from founders came up. Also, research into European VC firms' that take an active ownership approach backs the correlation of stage with the need for support.[553]

Another angle in being geographically far from founders are the cultural differences. They impact especially the due diligence process of a VC firm. When investing in a culturally distant market VC firms are more thorough in their screening which adds to the costs and complexity of the deal.[554] Some of the cultural differences are mitigated by the fact that start-up entrepreneurs, especially in tech, are a quite homogenous bunch. Once the accents and other superficial differences are looked past, they all have the same goals, tools and approaches. Some US VC firms investing in Africa, possibly to bridge the cultural gap, have invested in start-ups with founders who have studied in the US.[555] Research into the Kenyan founder profiles that have received funding supports this.[556] The diaspora has been seen as a

[549] Interview with Khaled Jilani from Africinvest on the 12th of March 2021, Hans Osnabrugge from Brooklyn Ventures on the 11th of March 2021, Johanna Raehalme from FinnFund on the 23rd of March 2021 and Funmi Makinwa from CcHub Nigeria on the 26th of March 2021
[550] Interview with Khaled Jilani from Africinvest on the 12th of March 2021 and their modus operandi will be covered in more depth as part of the third obstacle.
[551] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021
[552] Interview with Khaled Jilani from Africinvest on the 12th of March 2021
[553] Botazzi et al. 2008
[554] See Nahata et al. 2014
[555] ibid
[556] Hain and Jurowetzki 2018

major development driver on the continent[557] and it was proposed that Finnish VC firms could seek out similarly start-ups with a hybrid background.[558]

Post analysis the obstacle is valid but only in certain circumstances. Being geographically far from the founders causes major challenges for early ventures that require a lot of assistance or funds that take a very active role along the whole lifecycle[559]. Another circumstance in which the obstacle applies is start-ups that plan to stay local which in most cases would anyway wane the interest of the VC firm in the first place because of the immense growth potential needed from the target start-ups to justify the investment.[560]

6.2.3 Lack of Local Expertise & Networks

The lack of local expertise and networks was the most prevalent obstacle when considering venturing to African. It also was the main reason why Finnish VC firms have a geographic focus. In QI, 44% of interviewees mentioned local expertise & networks as the reason for having a geographic focus and in QIII 64% voiced it as an obstacle to venturing. Research backs this up, networks and local expertise are vital for good return in VC[561] and going abroad for a VC firm is an uphill battle because of the challenges associated with becoming familiar with a new market, monitoring it and building an advantageous network to get the most out of it.[562] Simultaneously, economic decentralization widened the playfield and created opportunities everywhere to disrupt and innovate so having a global network is growing in value.[563]

When this obstacle was brought forth to the interviewees operating in the African VC scene, every single one gave the same solution for this obstacle: co-investing. Finding local partners was something that was already discussed in Chapter 3.3. but with more emphasis on supportive services like legal advice and consulting. Co-investing has been a standard practice

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[557] Plaza and Ratha 2011
[558] Interview with Khaled Jilani from Africinvest on the 12th of March 2021 and Johanna Raehalme from FinnFund on the 23rd of March 2021
[559] For example, a fund that invests in just a handful of firms and takes a very active role in evolving the business. This might be typical in high-knowledge industries like life sciences where the founders are most often medical PhDs and need a partner in commercializing the innovation.
[560] Though Africa has some large internal markets the start-up will benefit from having a cross-border VC firm as part of the investment when taking the next steps into international markets.
[561] Hochberg et al. 2007
[562] Guler and Guillen 2010
[563] Saxenian and Sabel 2008

in VC for a long time in situations where the firms wish to share risk and information.[564] When venturing to emerging markets, as established through the blockers expressed by Finnish VC firms, this sharing of risk and information is exactly what the firms need.[565] Co-investing alters the task of the VC firm entering the market. Instead of seeking start-ups for investment opportunities the Finnish firm would now pursue finding and creating a strong partnership with a local firm that is able to bring investment these opportunities filtered through their networks and knowledge.[566] For the partnerships to work they need to be as frictionless as possible and built on a strong base of similar investment strategy and industry focus. These two areas align the goals of the VC firms when entering an investment. Overlap in experience, value adds[567] and methods of operation align the ways of getting there.[568] To figure out compatibility there is no big secret, just a transparent discussion.

So how to find this partner for co-investment? There are a few ways to approach the search. VC firms in the African ecosystem recognize that all activity strengthens the ecosystem and in the long run everyone benefits so the general attitude towards partnerships is very positive. Every single interviewee mentioned being open to co-investments with firms coming outside the continent. The process of finding a co-investment partner is similar to the actions undertaken by the writer of this thesis: doing research and reaching out. The first option when searching for a co-investment partner is to work back from deals. By simply finding deals on the continent that would have been interesting for the Finnish VC fund and then contacting the local VC firms that participated in those deals is an easy way to find firms that might be aligned in the earlier mentioned vital areas.[569] Another way is to contact hubs in the region. Hubs are very connected in their ecosystem and are glad to provide assistance for firms venturing into it.[570] Finally, by simply doing research. In the same way, a new area of tech is researched, spending time familiarising with the African ecosystem will uncover actors in the market that could potentially be a co-investment partner. FinnFund's approach is a combination of all of the above in addition to being active and visible in regional events. To

[564] See Steier and Greenwood 1995
[565] Khavul and Deeds 2016
[566] Dai and Nahata 2015
[567] Relating to the ways the VC firms will support the start-up.
[568] Khavul and Deeds 2016 and interview with Eric Osiakwan from Chanzo Capital on the 18th of March 2021
[569] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
[570] Interview with Funmi Makinwa from CcHub Nigeria on the 26th of March 2021

borrow a marketing term, staying top-of-mind is a vital part of FinnFunds strategy in Africa.[571] By being known in the ecosystem they get approached with deals that might otherwise be unavailable because all the best deals are quickly oversubscribed.[572]

There are a few ways for Finnish VC firms to structure these co-investing partnerships with VC firms in the African market. The first division is tied to the fact does the local VC firm also invest capital to become an equity partner in the start-up or not. There might be cases where the local VC firm has already invested all the capital of its fund or for a number of reasons is not willing or able to invest in the target start-up. In these cases, the co-investment is closer to the service relationship mentioned in Chapter 3.3. with the local VC firm handling services like deal-making, paperwork, legal processes and sitting on the board among others in exchange for a 1 to 2% equity stake to ensure aligned interests. The local VC can also act as a fiduciary on the ground for a fee but this is less common.[573]

In cases where the local VC invests alongside the foreign firm and becomes a sizable equity owner the partnership becomes a regular investment syndicate. Cross-border syndicates targeting emerging markets have historically performed better[574] than the local firm on its own investing domestically. The reasons behind this synergy benefit are myriad but the main one is sharing of knowledge[575]. The better performance of cross-border syndicates creates an incentive also for local firms to seek out foreign partners for their investments. Future returns of funds that have syndicated internationally also are positively affected as venturing with new partners provides new networks and experiences.[576] In the African VC world, this has been recognized and most VC rounds are "party rounds"[577].[578] FinnFund has also taken the same approach and they always co-invest with at least one VC firm that has an office in Africa when carrying out VC type investments in the African market.[579]

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[571] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021
[572] Interview with Khaled Jilani from Africinvest on the 12th of March 2021
[573] Interview with Eric Osiakwan from Chanzo Capital on the 18th of March 2021
[574] Though overlap is important there are bound to be learning opportunities and the partners become larger than their sum.
[575] Although it can be argued that the international firm is a high performer since it is venturing outside its home market and taking on international challenges which is proof of confidence from its investors and any investment where a firm like this is present would outperform an average domestic firm investing on its own.
[576] Khurshed et al. 2020
[577] Term for an investment round with multiple participants.
[578] Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021
[579] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021

The chapter with the most prevalent obstacle has the clearest solution. To overcome the challenge of not having local knowledge the VC firm should find a partner to co-invest with. The partner needs to align in at least strategy, value adds and industry focus for the partnership to work and for there to be enough overlap in experience and methods of operation for the culture difference to not be so conspicuous it creates friction. These cross-border co-investment partnerships are also proven in the early stages of the now burgeoning Israel's start-up market[580] and emerging economies of Asia[581] so why not Africa?

6.2.4 Corporate Governance & Unknown Risks

The corporate governance & unknown risks obstacle connects into many of the areas covered in the chapters on the legal landscape of each chosen country. Finnish VC firms raised concerns like minority shareholder protection, fraud, understanding their manoeuvre space and being able to trust the local law to be enforced. Unknown risks refer to the uncertainty relating to venturing to Africa "we do not know what we do not know" and good corporate governance being the mechanism to lessen surprises. In QI only 8% of Finnish VC firms brought it up as a reason for a mandate but in QIII 40% raised it as an obstacle.

This obstacle was something the interviewed investors in Africa likewise face when investing domestically.[582] The interviews on the obstacle confirmed the research done on the legal landscapes of the three chosen countries. South Africa has a relatively strong corporate governance system that can be relied on as an investor stemming from its strong stock market. Kenya falls second needing additional measures taken by VC investors to minimize risks and even with Nigeria recently enacting the Code of Corporate Governance it remains the most challenging ecosystem from a corporate governance standpoint as the effects are still slowly permeating through the start-up ecosystem.[583]

There might be differences in legal landscapes but the solutions given by the interviewees to minimize risks relating to the target start-ups are applicable across the continent; their importance is just more undeniable in certain jurisdictions. Unlike in Finland, where start-

[580] Khavul and Deeds 2016
[581] See Dai et al. 2012
[582] Even though interestingly all three African countries covered in the thesis rank better in minority protection than Finland in the GII.
[583] Darambola 2012 and Memba et al. 2012 and interviews with Khaled Jilani from Africinvest on the 12th of March 2021 and Funmi Makinwa from CcHub Nigeria on the 26th of March 2021

ups have a certain formality to their structure from the very beginning, an investment by a VC firm prompts the establishment of corporate governance for a start-up in Africa in most cases. The readiness of the firm for corporate governance needs to be determined through in-depth due diligence during which the local network is also of great importance giving their experience-based opinion.[584] The requirements for corporate governance are then set out in the term sheet creating barriers and demands.[585] FinnFund has an almost standardized framework of compliance they need their investments to execute on and with a clear checklist of what the firms need to accomplish before anything is signed and also what needs to be done post-signing.[586]

Another way of looking at the lack of corporate governance in pre-VC start-ups is that the investing VC firms have the opportunity to build corporate governance into a form that they prefer. This sets up the relationship to be more symbiotic when the governance is built through negotiation rather than the VC plugging in.[587] Corporate governance does not have to be built in an African jurisdiction[588].[589] Most foreign VC investors demand the start-ups to be incorporated in jurisdictions they understand and are more tax optimal than the domestic jurisdiction of the start-up almost becoming standard practice for African start-ups that receive foreign VC investments. American VC firms prefer Delaware and the Cayman Islands[590] for incorporation and European firms Mauritius.[591] Jurisdictions where the VC firms are used to operating ease the investment process, lower investment-related risks, create a better base for additional funding or exits and enable the VC fund to lower its tax burden.[592]

Once the place of incorporation has been decided there are a few mechanisms to insert into the term sheet to de-risk the investment by addressing the concerns listed at the beginning of the chapter. The objective is to stem blind spots and be well aware of what is happening

[584] Interview with Vasiliki Ntina from AVCA on the 16th of March 2021 and Johanna Raehalme from FinnFund on the 23rd of March 2021
[585] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
[586] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021
[587] Interview with Eric Osiakwan from Chanzo Capital on the 18th of March 2021
[588] Similarly to the mandate obstacle, it seems that for African start-ups a path to international capital is incorporating outside the continent.
[589] Ndemo and Weiss 2017
[590] Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021 and Khaled Jilani from Africinvest on the 12th of March 2021 and Funmi Makinwa from CcHub Nigeria on the 26th of March 2021
[591] Interview with Johanna Raehalme from FinnFund on the 23rd of March 2021
[592] See Cumming and Johan 2014

in the business.[593] Thresholds for capital burn, placing a new C-level executive in, independent board members that are non-executive or alternatively observer seats and regular statements on the progress of the business are methods utilized by African investors.[594]

Setting thresholds is similar to milestone financing[595] which has been utilized in VC for a long time to break down the investment into tranches that are contingent on the firm reaching certain milestones to receive the next chunk of financing.[596] The difference in thresholding is the capital release method. The investor sets a certain cash burn rate that is not tied to any milestones but is instead tied to passage of time; an x amount of dollars is authorized for the following 3-month period and any additional capital needs board approval. By thresholding, the investor understands what is happening in the firm and capital exposure is constantly at a low level.[597]

Placing a new C-level executive into a start-up is also a practice employed outside the continent. Bringing in a new high-level executive with the VC investment helps the start-up transition towards the next stage of its growth cycle with a fresh perspective.[598] In addition to these benefits, a new C-level executive "infiltrates" the inner working of the day-to-day business and hiding any questionable activity in a start-up from someone in such a key role is very difficult.[599] Having independent board members that are non-executive or observer seats on the board accomplish the same goal on a bit higher level keeping the strategic decisions making in check and aligned with the VC firms' targets.[600]

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593 Interview with Dustyn Winder from Akili Ventures on the 17th of March 2021
594 Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021 and Eric Osiakwan from Chanzo Capital on the 18th of March 2021
595 Utilized often in cases where the venture is a long-shot or the venture capitalist's role is central to success. Long shot ventures are for example biopharma drug development where the VC firm might release more and more capital as the firm manages to prove the viability of the drug in development through research. If the drug fails, there is no need for capital anyway, so milestone financing is an optimal way for the VC firm to incentivise progress. When the venture capitalist's knowledge or network is vital to the success of the venture releasing all the capital to the entrepreneur is not in the best interest of the VC firm since it will anyway be the driving force behind the venture.
596 Cuny and Talmor 2005
597 Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021
598 See Gerasymenko et al. 2015
599 ibid
600 Interview with Eric Osiakwan from Chanzo Capital on the 18th of March 2021 and Funmi Makinwa from CcHub Nigeria on the 26th of March 2021

Additionally, to the ex-ante methods of minimizing risks ex-post the VC firm can utilize well planned recurring reporting to follow key financial and non-financial metrics.[601] The IFC Toolkit for Disclosure and Transparency is something that is utilized on the continent when building reporting of the start-up.[602]

Another point of view that was brought up during the interviews is not the risk between the investor and start-up but between the start-up and the market. Informal processes, as the thesis has demonstrated, are an element in the start-ups business dealings and these open the firm and its owners to risks.[603] Firms need to navigate the environment recognizing where challenges arise and how to tackle them without opening the firm to liability and breaking the law but remaining competitive. This is a fine art[604], dubbed in the interview as "AI"[605] that requires someone on the ground[606].[607]

A Finnish VC firm overcome this obstacle with good due diligence, placing a new executive into the start-up, thresholding, independent board members or observing board seats and well-structured reporting. On the flip side all these actions taken to minimize risks are time and resource consuming and additional to the traditional role of a VC investor. Recognizing this helps the VC firm price these costs into the investment and examine risk minimization options already during the due diligence process. Also, the firm needs to reflect is it able to put in the effort required to reach a risk level it is comfortable with. However, the solution to the previous obstacle in a way is intertwined with the solution to corporate governance and unknown risks; the co-investment partner is able to take on these challenges with the experience from the local market and the Finnish VC can focus on other value adds.

[601] See Wang et al. 2017
[602] Interview with Funmi Makinwa from CcHub Nigeria on the 26th of March 2021
[603] See Saka-Helmhout et al. 2020 and Goel et al. 2020
[604] The example given was dealing with business situations where bribes might be asked for and if not provided, might cause issues for the business. The entrepreneur in collaboration with the investors needs to figure out a way to circumvent this situation because besides the ethical issues there is no place on the balance sheet for bribes.
[605] African Intelligence
[606] Relating back to the previous blocker and having a co-investment partner who understands the challenges.
[607] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021

7 Conclusion

The objective of the thesis was to establish the main blockers for Finnish VC firms when weighing the option of investing in Africa and then provide solutions to overcome them whilst acting as a roadmap for a Finnish firm looking to venture into one of the three chosen jurisdictions. The chosen jurisdictions reflect the different environments across the continent. To oversimplify the country profiles: Nigeria has a somewhat turbulent ecosystem producing a lot of innovation, South Africa has a stable ecosystem with good structures but stagnating economically and Kenya is the country with a rapidly developing ecosystem and a bright future. By investing in any of these countries, VC firms have a chance to make an impact like nowhere else; every investment is an impact investment.[608]

The most prevalent obstacles in the way of venturing to Africa expressed by the firms were mandates, being geographically far from founders, lack of local expertise & networks and corporate governance & unknown risks. As each obstacle was delved into, solutions emerged but so did barriers that were found insurmountable. These insurmountable "sub-obstacles" characterize the profile of a fund that would be able to venture to Africa from Finland. The fund needs to optimally tick four boxes: *1. Cannot be focused on early stage start-ups. 2. Needs to find a local co-investor. 3. Cannot have a mandate blocking Africa as an investment option. 4. Is a specialized fund.*

Out of the obstacles that morphed into a four-point checklist the first three are more irremissible than the last one. Early stage start-ups need too much assistance to be invested in without close contact, without a co-investor the learning curve and cost associated with gaining a foothold in the market would be too high and a mandate blocking investment in Africa is also incontestable. The fourth point, specialization of a fund, is not mandatory but the consensus in research seems to point to the fact that venturing outside your domestic geography as a generalist does not add value for the investors but for those pioneering specialized funds that are ready to join the first wave of top international VC firms in Africa ample opportunities await.

[608] Interview with Tito Cookey-Gam from Echo VC on the 18th of March 2021

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Appendixes

Appendix A: Fund structure of Icebreaker Fund I

OUR FUND AND ITS INVESTORS

Name of the fund: Icebreaker Fund I Ky
Current fund size: €20 million

Investor shares:

30% Tekes VC
28% Family offices and seasoned tech entrepreneurs
10% Varma Mutual Pension Insurance Company
8% OP Financial Group
5% Elo Mutual Pension Insurance Company
5% The Seafarer's Pension Fund
5% Draper Esprit
4% Tradeka-Invest
3% Ålands Ömsesidiga Försäkrningsbolag
2% Icebreaker team members

Source: Icebreaker.vc sijoittajastruktuuri (https://www.icebreaker.vc/about)

Appendix B: Data from questions to Finnish VC firms to discover obstacles

Q1: "Why do you have a geographic focus on investments?" ("Miksi teillä on maantieteellinen rajaus sijoituksissa?")

Obstacle	Amount	As % of total	As % of people answering
Founded with Finnish market in mind	3	7 %	12 %
Mandate	10	24 %	40 %
Being geographically close to founders	9	22 %	36 %
Networks	6	15 %	24 %
Local expertise	5	12 %	20 %
Corporate Governance	2	5 %	8 %
Lack of Resources	5	12 %	20 %
Fear of intense competition	1	2 %	4 %
Total	41		

Q3: "Why did you answer Yes/No to the previous question?" ("Miksi vastasitte kyllä/ei edelliseen kysymykseen?") with the previous question being:" "Have you ever thought of investing in Africa?" ("Oletteko koskaan harkinneet Afrikkaan sijoittamista?")

Obstacle	**Amount**	**% of Total**	**As % of people answering**
Founded with Finnish market in mind	3	6 %	12 %
Mandate	5	9 %	20 %
Being geographically close to founders	8	15 %	32 %
Local expertise	10	19 %	40 %
Lack of Resources	5	9 %	20 %
Lack of Dealflow	4	8 %	16 %
Corporate Governance	6	11 %	24 %
Network	6	11 %	24 %
Unknown Risks	4	8 %	16 %
Taxation	1	2 %	4 %
Lack of Confidence	1	2 %	4 %
Total	53		

Appendix C: People Interviewed

The following table lists all the people interviewed for the thesis that did not wish to remain anonymous.

Name	**Position**	**Firm**
Dustyn Winder	Founder and Managing Partner	Akili Ventures
Ebubechukwu Nnachi	Intern	CcHub Nigeria
Eric Osiakwan	Managing Partner	Chanzo Capital
Funmi Makinwa	Compliance Manager	CcHub Nigeria
Hans Osnabrugge	Partner	Brooklyn Ventures
Johanna Raehalme	Investment Manager	FinnFund
Khaled Jilani	Senior Partner	Africinvest
Petri Serenius	Investment Director	Business Finland VC
Tito Cokey-Gam	Senior Analyst	Echo VC
Vasiliki Ntina	Research Associate	AVCA